

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 1998**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

A. Basis of Presentation - The accompanying financial statements of the State of Tennessee have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board. The financial statements of the Colleges and Universities have been prepared in conformity with generally accepted accounting principles for colleges and universities as prescribed by the Governmental Accounting Standards Board. Certain amounts presented for the preceding year have been reclassified for comparative purposes.

B. Financial Reporting Entity

Introduction - As required by generally accepted accounting principles, these financial statements present the primary government and its component units, entities for which the government is considered to be financially accountable. Discretely presented component units are reported in a separate column in the combined financial statements to emphasize they are legally separate from the primary government.

Discretely Presented Component Units.

1. The Tennessee Student Assistance Corporation (TSAC) (Governmental Fund Type) is responsible for guaranteeing student loans under both federal and state programs and administering federal and state grants and loans to students. The majority of the Board is either appointed by the Governor or are State officials. TSAC's budget is approved by the State.
2. The Community Services Agencies (CSAs) (Governmental Fund Types) listed below are to provide a mechanism to facilitate the provision of services for children and other citizens in need of services from state agencies:

Davidson County Community Services Agency  
Knox County Community Services Agency  
Shelby County Community Services Agency  
Hamilton County Community Services Agency  
Northeast Community Services Agency  
East Tennessee Community Services Agency  
Upper Cumberland Community Services Agency  
Southeast Community Services Agency  
Mid-Cumberland Community Services Agency  
South Central Community Services Agency  
Northwest Community Services Agency  
Southwest Community Services Agency

The Boards for these CSAs are appointed by the Governor and the budget must be approved by the State.

3. TN 200 (Governmental Fund Type) was formed to develop a comprehensive program for celebrating the bicentennial of the State. The Board is comprised of State officials and appointees by the Governor, and the State provides a substantial amount of funding.
4. The Tennessee Certified Cotton Growers Organization (Governmental Fund Type) was formed to aid in the eradication of the Boll Weevil. The majority of the Board is appointed by the Commissioner of the Department of Agriculture, and the State provides a substantial amount of funding.
5. The Tennessee Housing Development Agency (Proprietary Fund Type) is responsible for making loans and mortgages to qualified sponsors, builders, developers and purchasers of low and moderate income family dwellings. The Board of the agency is appointed by the Governor and its budget is approved by the State.

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6. The Tennessee Local Development Authority (Proprietary Fund Type) provides financing assistance to local governments through the issuance of bonds and notes. In addition, the Authority assists non-profit corporations in the construction of mental health, mental retardation, or alcohol and drug facilities. The majority of the Board consists of State officials; therefore, the State can impose its will on the Authority.
7. The Tennessee Commodity Producer Indemnity Board (Grain Indemnity) (Proprietary Fund Type) is responsible for administering the grain indemnity fund. This fund receives monies from assessments on the sale of grain by producers. These monies are then used to compensate any claimant who has incurred a financial loss due to a failure of a commodity dealer or warehouseman. The Board is comprised of state officials and the State may impose its will since the State appoints, hires and dismisses those individuals responsible for the day-to-day management of the organization.
8. The Tennessee State Veterans' Homes Board (Proprietary Fund Type) is responsible for the operation of nursing homes for honorably discharged veterans of the United States armed forces. The Board is appointed by the Governor and its budget is approved by the State. In addition, the issuance of bonds must be approved by the State Funding Board.
9. The Child Care Facilities Corporation (Proprietary Fund Type) purpose is to create new child care slots in Tennessee by guaranteeing loans, making direct loans, and making grants. The Board is comprised primarily of State officials. The State must approve the budget of the Corporation.
10. The Tennessee State School Bond Authority (Proprietary Fund Type) finances projects for the University of Tennessee, Tennessee Board of Regents or the Tennessee Student Assistance Corporation. The Board of the Authority consists primarily of State officials; therefore, the State is able to impose its will on the organization.
11. The University of Tennessee Board of Trustees (College and University Fund Type) is responsible for the operation of the University of Tennessee, located primarily on four campuses across the State. The Board is appointed by the Governor and the State provides a substantial amount of the funding.
12. The Tennessee Board of Regents (College and University Fund Type) is responsible for the operation of six universities, twelve community colleges, two technical institutes and twenty-seven technology centers. The Board is comprised of State officials and appointees by the Governor and the State provides a substantial amount of funding.

Complete financial statements for each of the individual component units may be obtained at the following addresses:

Tennessee Housing Development Agency 1114 Parkway Towers 404 James Robertson Parkway Nashville, TN 37243	Tennessee Local Development Authority Suite 1600, James K. Polk Building Nashville, TN 37243
Tennessee State Veterans' Homes Board 345 Compton Road Murfreesboro, TN 37130	Tennessee State School Bond Authority Suite 1600, James K. Polk Building Nashville, TN 37243
University of Tennessee Office of the Treasurer 301 Andy Holt Tower Knoxville, TN 37996-0100	Tennessee Board of Regents 1415 Murfreesboro Road, Suite 350 Nashville, TN 37217

All others may be obtained at the following address:  
Finance & Administration  
Division of Accounts  
15th Floor Andrew Jackson Building  
Nashville, TN 37243-0298

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- C. Fund Structure and Basis of Accounting - The financial activities of the state reported in the accompanying statements are classified into three fund categories and two account groups, all described below. The fund categories include governmental funds, proprietary funds and fiduciary funds. Account groups are presented for general fixed assets and general long-term obligations.

The state's governmental fund types include:

1. the General Fund - used to account for all financial transactions not required to be accounted for in other funds;
2. the Special Revenue Funds - used to account for specific revenues earmarked to finance particular or restricted programs and activities;
3. the Debt Service Fund - used to account for the payment of principal and interest on general long-term debt; and
4. the Capital Projects Fund - used to account for the acquisition or construction of all major governmental capital facilities.

All of the governmental funds are accounted for on the modified accrual basis of accounting. Under this basis, revenues are recognized when they become susceptible to accrual; that is, when they become both measurable and available to finance expenditures of the current period. Principal revenue sources accounted for on the modified accrual basis include federal grants, departmental services, interest on investments, sales taxes, petroleum and vehicular-related taxes and fees, and gross receipts taxes. Licenses, fines, fees and permits are accounted for on the cash basis. Expenditures are recognized when the related fund liability is incurred except:

- a. Inventories generally are considered expenditures when consumed;
- b. Prepayments usually are not recorded; and
- c. Principal and interest on long-term debt are recorded when due.

Encumbrance accounting is utilized for budgetary control purposes in governmental fund types. Encumbrances outstanding at year-end are reported as reservations of fund balance for subsequent year expenditure.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds and expendable trust funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

The proprietary funds include:

1. the Enterprise Funds - used to account for the operations of self-sustaining state agencies providing goods or services to the general public on a user-charge basis; and
2. the Internal Service Funds - used to account for the operations of self-sustaining state agencies providing goods or services to other state agencies on a cost-reimbursement basis.

The proprietary funds are accounted for on the accrual basis. Under this method, revenues are recorded when earned and expenses at the time liabilities are incurred.

The fiduciary funds represent Trust and Agency Funds which are used to account for assets held by the state in a trust or agency capacity. These funds include:

1. the Expendable Trust Funds - used to account for the activities of trusts whose principal and income may be used for the purposes of the trust;
2. the Nonexpendable Trust Funds - used to account for the activities of trusts whose income is used to fund the trust purpose but whose principal is to be maintained intact;
3. the Pension Trust Fund - used to account for the activities of the state-administered retirement system;
4. Investment Trust Fund – used to account for the activities of the state sponsored external investment pool; and
5. the Agency Funds - used to account for amounts held in custody for others. Agency funds are custodial in nature and do not present results of operations or have a measurement focus.

Expendable Trust and Agency Funds are accounted for on the modified accrual basis of accounting. Nonexpendable, Pension Trust and Investment Trust Funds are accounted for on the accrual basis.

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All proprietary funds, nonexpendable trust funds, pension trust and investment trust funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. Proprietary fund-type operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets.

The financial statements of the pension plans are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. The state's contributions are recognized when due and a formal commitment to provide the contributions has been made. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

The account group for general fixed assets is maintained to account for all fixed assets acquired or constructed for use by the state, other than those accounted for in the proprietary funds.

The account group for general long-term obligations is maintained to account for general obligation bonds outstanding, arbitrage payable, claims payable and accrued annual and compensatory leave not otherwise recorded in proprietary or fiduciary funds.

In addition to the forementioned fund categories and account groups, the component units also include colleges and universities which are accounted for using a different accounting and reporting model.

The college and university fund types (component units - discrete) include:

1. Current Funds - used to account for resources that will be expended in the near term for operating purposes of the institutions. These include (a) unrestricted funds over which the governing boards retain full control in achieving the institutions' purposes and (b) restricted funds which may be utilized only in accordance with externally-restricted purposes;
2. Fiduciary Funds - used to account for assets held by loan, endowment, life income and agency funds in which the universities act in a fiduciary capacity; and
3. Plant Funds - used to account for institutional property acquisition, renewal, replacement, debt service and investment.

The college and university fund types are accounted for on the accrual basis of accounting with the following exceptions:

- A. Depreciation expense related to plant fund assets is not recorded; and
  - B. Revenues and expenditures of an academic term encompassing more than one fiscal year are solely reported in the fiscal year in which the term is predominantly conducted.
- D. Proprietary Activity Accounting and Financial Reporting - Activities accounted for in the state's proprietary, non-expendable trust and pension trust funds and proprietary type component units follow all applicable GASB pronouncements as well as applicable private sector pronouncements issued on or before November 30, 1989.
- E. College and University Accounting and Financial Reporting Model - The state uses the AICPA college guide model for accounting and reporting guidance for its colleges and universities, which are presented as component units-discrete.
- F. Budgetary Process - Legislation requires the Governor to present his proposed budget to the General Assembly at the beginning of each annual session. Annual budgets are adopted for the general and special revenue funds, except the Supreme Court Boards, Fraud and Economic Crime and Dairy Promotion Board (accounted for as Special Revenue Funds). The General Assembly enacts the budget through passage of specific departmental appropriations, the sum of which may not exceed estimated revenues. Before signing the Appropriations Act, the Governor may veto or reduce any specific appropriation, subject to legislative override. Once passed and signed, the budget becomes the state's financial plan for the coming year.

Budgetary control is maintained at the departmental level. Budget revisions during the year, reflecting program changes or intradepartmental transfers of an administrative nature, may be affected with certain executive and legislative branch approval. Only the legislature, however, may transfer appropriations between departments.

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Unencumbered appropriations lapse at the end of each fiscal year, with the encumbered appropriations being carried forward to the next year. In order to provide sufficient funding for several programs during the year, supplemental appropriations of \$20.5 million were required.

The state's annual budget is prepared on the modified accrual basis of accounting with several exceptions, principally the effect of encumbrance and contract obligations. Because these exceptions represent departures from generally accepted accounting principles (GAAP), actual amounts in the accompanying budgetary comparison statement are presented on the budgetary basis. A reconciliation of the differences between the budgetary and GAAP basis is presented in Note 2B. The budgetary comparison statement includes the General Fund and all budgeted Special Revenue Funds.

G. Cash and Cash Equivalents - This classification includes demand accounts, petty cash and monies in cash management pools. The liquidity of the cash management pools is sufficient to cover any withdrawal request by a participant. This classification also includes short-term investments with a maturity date within three months of the date acquired by the state. These short-term investments, which are not part of the State Cash Pool, are stated at fair value. Investments in the State Cash Pool are stated at cost or amortized cost as this pool is a 2a7-like pool. Collateral, as required by law, is pledged by the various banks and government securities dealers to guarantee state funds placed with them. It is the state's policy to include cash management pools as cash. In addition, all securities whose primary purpose is to facilitate the placement of funds in long-term investment vehicles are classified as investments.

H. Investments - This classification includes long-term investments which are stated at fair value.

Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair values. Investment income consists of realized and unrealized appreciation in the fair value of investments. Interest income is recognized when earned. Securities and security transactions are recorded in the financial statements on trade-date basis.

I. Receivables - Receivables in the state's governmental and fiduciary funds primarily consist of taxes, interest, departmental services and federal revenues, recorded when earned. The remaining governmental fund revenues are not considered susceptible to accrual prior to receipt; accordingly, licenses, fees, fines, permits and similar revenues are recognized on the cash basis. Certain Trust Fund receivables, representing taxes and benefits overpayments, have been reduced by an allowance for uncollectibles. Receivables in all other funds have arisen in the ordinary course of business. College and University receivables have also been reduced by an uncollectible allowance.

J. Interfund Transactions - The state basically has four types of interfund transactions, as follows:

1. Services rendered and employee benefit contributions. These transactions are accounted for as revenues, expenditures or expenses in the funds involved.
2. Operating appropriations/subsidies. These are accounted for as operating transfers in the funds involved.
3. Equity contributions. These are accounted for as equity transfers (additions to or deductions from beginning governmental fund balances or proprietary fund contributed capital).
4. College and university interfund borrowings. These transactions represent borrowings of a temporary nature and are reported as assets of the college and university fund making the advance and as liabilities of the fund receiving the advance.

The composition of the state's due to/from other funds at June 30, 1998 is presented in Note 2E.

K. Advances to Other Funds - Noncurrent portions of long-term interfund loan receivables are reported as advances and are offset equally by a fund balance reserve account which indicates that they do not constitute expendable available financial resources and therefore are not available for appropriation.

L. Inventories - Inventories of materials and supplies are determined by physical count and are valued at cost, principally using the first-in/first-out (FIFO) method. The average cost method is used for the Highway Fund (a Special Revenue Fund) and Motor Vehicle Management (an Internal Service Fund). The costs of governmental fund-type inventories are recorded as expenditures when consumed rather than when purchased.

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- M. Fixed Assets and Depreciation - General fixed assets are presented in the accompanying financial statements at cost or estimated historical cost. Donated fixed assets are stated at fair market value at the time of donation. Interest during construction has not been capitalized. Also, certain public domain fixed assets (including highways, bridges, highway lands and rights-of-way) are not capitalized. No depreciation is provided on general fixed assets.

Enterprise, Internal Service and Nonexpendable Trust Fund fixed assets are stated at cost or estimated historical cost. Donated fixed assets are stated at fair market value at the time of donation. They are being depreciated principally on a straight-line basis over estimated useful lives ranging from 20 to 50 years for Structures and Improvements and 4 to 20 years for Machinery and Equipment. It is the state's policy to capitalize interest expense incurred on significant assets during their construction.

A statement of changes in general fixed assets for the year ended June 30, 1998 is presented in Note 2A.

Generally, College and University component units fixed assets are stated at cost and are not depreciated. Donated fixed assets are stated at fair market value at the time of donation. Because of the magnitude of library holdings, however, it has been the state's policy to value library books at a standard amount per volume, currently \$48, which approximates cost.

- N. Accumulated Unpaid Vacation and Sick Pay - The state's liability for accumulated unpaid annual and compensatory time is reported in the accompanying General Long-Term Obligations Account Group for all governmental fund types. In the proprietary fund types and the college and university fund types, this obligation is reported as a fund liability.

There is no liability in the accompanying financial statements for unpaid accumulated sick leave since it is the state's policy to record the cost of sick leave only when paid. This contingency amount is disclosed in Note 9A.

- O. Fiscal Year End - The fiscal year end of the primary government and component units is June 30, except for the following agencies reported as Special Revenue funds: Supreme Court Boards and Dairy Promotion Board. Both of these organizations have a December 31 year end., and the University Health System (a component unit of the University of Tennessee), also has a December 31 year end.

- P. Fund Balance Reserves and Designations - The state's fund balance reserves represent those portions of fund balance (1) not appropriable for expenditure or (2) legally segregated for a specific future use. In the accompanying Combined Balance Sheet, reserves for related assets such as inventories, petty cash, advances, long-term receivable, and prepayments are examples of the former. Reserves for encumbrances, contracts, continuing appropriations and other specific purposes are examples of the latter. The state's fund balance designations reflect tentative plans for future use of financial resources. The General Fund designation for revenue fluctuations, has been established as protection in the event of future revenue shortfalls or expenditure overruns.

- Q. Totals (Memorandum Only) - Total columns on the general-purpose financial statements are captioned "memorandum only" to indicate that they are presented only to facilitate financial analysis. Data in these columns do not present financial position, results of operations or cash flows in conformity with generally accepted accounting principles. Neither are such data comparable to a consolidation. Interfund eliminations have not been made in the aggregation of this data.

- R. Comparative Data - Comparative total data for the prior year have been presented in the accompanying financial statements in order to provide an understanding of changes in the government's financial position and operations. However, comparative data have not been presented in all statements because their inclusion would make certain statements unduly complex and difficult to understand.

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**NOTE 2 - OTHER ACCOUNTING DISCLOSURES**

A. General Fixed Assets - A statement of changes in general fixed assets for the year ended June 30, 1998 is shown below (expressed in thousands). The beginning balance of equipment has been adjusted, as the state increased the capitalization criteria from \$500 to \$1,000.

	<u>Land</u>	<u>Structures and Improvements</u>	<u>Machinery and Equipment</u>	<u>Construction in Progress</u>	<u>Totals</u>
Balance, July 1, 1997	\$144,738	\$1,056,839	\$353,143	\$ 55,692	\$ 1,610,412
Beginning Balance Adjustment			<u>(25,872)</u>		<u>(25,872)</u>
Adjusted Balance, July 1, 1997	144,738	1,056,839	327,271	55,692	1,584,540
Additions	12,029	27,727	55,078	72,737	167,571
Deductions	<u>(2,474)</u>	<u>(4,908)</u>	<u>(36,521)</u>	<u>(25,755)</u>	<u>(69,658)</u>
Balance, June 30, 1998	<u>\$154,293</u>	<u>\$1,079,658</u>	<u>\$345,828</u>	<u>\$ 102,674</u>	<u>\$1,682,453</u>

B. Budgetary Basis vs. GAAP - The accompanying Combined Statement of Revenues, Expenditures and Changes in Fund Balances - Budget and Actual - General Fund and All Budgeted Special Revenue Fund Types presents comparisons of the legally adopted budget with actual data on a budgetary basis. Since the budgetary and GAAP presentations of actual data differ, a reconciliation of the two is presented below (expressed in thousands).

	<u>General Fund</u>	<u>All Special Revenue Funds</u>
Fund Balances (Budgetary Basis), June 30, 1998	\$ 570,745	\$ 160,924
Add:		
Reserve for encumbrances and contracts	7,095	178,112
Highway construction appropriations carried forward		145,341
Unbudgeted Supreme Court Boards		2,241
Unbudgeted Fraud and Economic Crime		<u>1,488</u>
Fund Balances (GAAP Basis), June 30, 1998	<u>\$ 577,840</u>	<u>\$ 488,106</u>

C. Fund Equity Restatement -

Change in Accounting Principle: During fiscal year 1998, the State implemented a new accounting standard (GASB Statement 31) to value certain investments at fair value. The effect on prior periods of valuing investments at fair value has been reported as a “cumulative-effect type accounting change” – an adjustment to beginning fund equity in the operating statement. The change in fair value of investments (realized and unrealized gains and losses) and interest and dividend income are reported as “Investment Income”. The effect of this change in accounting principle on the balance sheet is an increase/decrease in Investments and on the operating statement an increase/decrease in Revenues and Fund Equity.

The State revised its capitalization policy to increase the amount required to capitalize assets from \$500 to \$1,000. As a result, OIR reduced its fixed assets and fund equity.

Prior Period Adjustments: The Office for Information Resources (OIR), an Internal Service Fund, has a prior period adjustment because equipment was overstated by \$701 thousand. The Facilities Revolving Fund (FRF), an Internal Service Fund, has a prior period adjustment because expenditures were understated by \$502 thousand. These errors caused the previous year’s fund equity to be overstated.

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Restatement – GASB 31: The General Fund was restated to include the administrative fees formerly accounted for in the Local Government Investment Fund.

In addition, the new accounting standard requires that the State’s investment pool be divided between external participants (local governments) and internal participants (funds of the primary government and its component units). The external portion of the investment pool must be reported as an investment trust fund in a Statement of Net Assets and a Statement of Changes in Net Assets. The equity position of the funds comprising the internal portion must be reported as an asset in those funds. As a result, the Local Government Investment Pool, an expendable trust fund, was restructured. External participants’ pool balances are reported in the Local Government Investment Fund and the primary government funds participants’ balances are reported as cash and cash equivalents in those funds.

	General Fund	Internal Service Funds	Nonexp. Trust Fund	Expendable Trust Funds	Investment Trust Fund	Component Units	Reporting Entity
Fund Equity and other credits as of June 30, 1997	\$ 345,612	\$ 329,016	\$ 157,329	\$ 917,543		\$ 4,352,981	\$ 27,095,099
Cumulative-effect type accounting change			26,230			76,134	102,364
Prior Period Adjustment		(1,203)					(1,203)
Change in Accounting Principle		(2,788)					(2,788)
Restatement-GASB 31	<u>2,435</u>	<u>          </u>	<u>          </u>	<u>(2,435)</u>	<u>\$ 1,181,502</u>	<u>          </u>	<u>1,181,502</u>
Fund Equity and Other Credits as of June 30, 1997, Restated	<u>\$ 348,047</u>	<u>\$ 325,025</u>	<u>\$ 183,559</u>	<u>\$ 915,108</u>	<u>\$ 1,181,502</u>	<u>\$ 4,429,115</u>	<u>\$ 28,374,974</u>



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D. Segment Information - Segment financial information for the state's Enterprise Funds for the year ended June 30, 1998, is presented below (expressed in thousands). These enterprise funds provide the following types of goods or services (in the order shown below): Sewage treatment loans, sewage treatment facilities loans, energy loans, insurance, insurance, drinking water system loans, and property distribution.

	State Loan <u>Program</u>	Sewer Treatment <u>Loan</u>	Energy Loan <u>Program</u>
Operating Revenues	\$ 1,356	\$ 12,134	\$ 728
Depreciation and Amortization			
Operating Income (Loss)	(95)	12,134	728
Operating Grants, Entitlements, and Shared Revenues		880	1,519
Operating Transfers In			
Operating Transfers Out to Component Units	25		
Net Income (Loss)	(120)	12,134	2,247
Current Capital Transfers		32,167	
Equity Transfers In		1,875	
Property, Plant and Equipment:			
Additions			
Deletions			
Net Working Capital	2,872	96,418	11,727
Total Assets	31,395	313,585	16,145
Bonds and Other Long-Term			
Liabilities Payable from			
Operating Revenues	23,560		
Total Equity	3,898	313,094	15,933

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Teacher Group <u>Insurance</u>	Local Government <u>Group Insurance</u>	Drinking <u>Water</u>	Property <u>Utilization</u>	<u>Totals</u>
\$ 109,004	\$ 33,286	\$ 94	\$ 1,546	\$ 158,148
			8	8
2,681	2,407	94	(106)	17,843
		169		2,568
			1	1
				25
3,647	2,969	94	(105)	20,866
		78		32,245
		2,500	200	4,575
			19	19
			16	16
5,086	7,969	2,572	365	127,009
21,113	11,724	2,694	567	397,223
				23,560
5,086	7,969	2,672	373	349,025

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E. Due To/Due From Other Funds - A summary of due from other funds and due to other funds at June 30, 1998 is shown below (expressed in thousands).

DUE FROM OTHER FUNDS					
<u>DUE TO OTHER FUNDS</u>	<u>General Fund</u>	<u>Special Revenue</u>		<u>Internal Service</u>	<u>Trust and Agency Funds</u>
		<u>Highway</u>	<u>Wildlife Resources Agency</u>	<u>Office for Information Resources</u>	<u>Employment Security</u>
General					\$ 85
Special Revenue:					
Education Trust	\$ 252,223			\$ 64	
Highway					
Wildlife Resources Agency					
Solid Waste					
Hazardous Waste					
Underground Storage Tanks					
Driver Education					
Salvage Title Enforcement					
Drycleaner's Environmental Response					
Tennessee Regulatory Authority					
Enterprise:					
Property Utilization					
Internal Service:					
Office for Information Resources					
Motor Vehicle Management					
General Services					
Printing					
Food Services					
Postal Services					
Purchasing					
Central Stores	132				
Records Management					
Trust and Agency:					
Employee Flexible Benefits	51	\$ 15	\$ 2		
Totals	<u>\$ 252,406</u>	<u>\$ 15</u>	<u>\$ 2</u>	<u>\$ 64</u>	<u>\$ 85</u>

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DUE FROM OTHER FUNDS					
Trust and Agency Funds					
Employee Flexible Benefits	Baccalaureate Education	Pension Trust	Contingent Revenue	Deferred Compensation	Totals
	\$ 2	\$ 1,211	\$ 5,092	\$ 70	\$ 6,460
		38	163	4	252,492
	1	175	745	11	932
		26	115	4	145
		1	5		6
		3	13		16
		3	15		18
			1		1
		1	1		2
			1		1
\$ 1		4	20		25
		1	4		5
		18	75	2	95
		1	6		7
		2	8		10
			1		1
		2	7		9
		2	8		10
		1	2		135
		1	3		4
					68
<u>\$ 1</u>	<u>\$ 3</u>	<u>\$ 1,490</u>	<u>\$ 6,285</u>	<u>\$ 91</u>	<u>\$ 260,442</u>

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F. Due to Primary Government From Component Units - A summary of due to the primary government from the component units at June 30, 1998 is shown below (expressed in thousands).

DUE FROM COMPONENT UNITS							
			Enterprise Funds		Internal Service Funds		
			Local Govt. Group Insc.	Property Utiliz.	Office for Information Resources	Motor Vehicle Management	Facilities Revolving Fund
<u>DUE TO PRIMARY GOVERNMENT</u>	<u>General</u>	<u>Capital Projects</u>					
TN Student Assistance Corporation							
Northeast CSA	\$ 339				\$ 5		
East TN CSA	313				2		
Upper Cumberland CSA	106						
Southeast CSA	132				7		
Mid-Cumberland CSA	145				18		
South Central CSA	147				4		
Northwest CSA	197				5		
Southwest CSA	335				6		
Davidson Co. CSA	39						
Knox Co. CSA	169		\$ 12		2		
Shelby Co. CSA	243						
Hamilton Co. CSA	196						
Tennessee Housing Development Agency	131						
Veteran’s Nursing Home	554						
Board of Regents	1,271	\$ 73		\$ 2	538	\$ 15	\$ 3
University of Tennessee	67			2	62	5	
Totals	<u>\$ 4,384</u>	<u>\$ 73</u>	<u>\$ 12</u>	<u>\$ 4</u>	<u>\$ 649</u>	<u>\$ 20</u>	<u>\$ 3</u>

STATE OF TENNESSEE

NOTES TO THE FINANCIAL STATEMENTS (Continued)

JUNE 30, 1998

DUE FROM COMPONENT UNITS							
Internal Service Funds		Trust and Agency Funds					
Central Stores	Legislative Services	Employment Security	Employee Flexible Benefits	Chairs of Excellence	Pension Trust	Contingent Revenue	Totals
					\$ 1	\$ 5	\$ 6
							344
					14		329
		\$ 1			6		113
					5		144
		2			18		183
							151
					11		213
		1			13		355
							39
							183
		1			16		260
							196
			\$ 1		6	25	163
		1					555
\$ 5	\$ 1				834		2,742
14				\$ 410	1,061		1,621
<u>\$ 19</u>	<u>\$ 1</u>	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ 410</u>	<u>\$ 1,985</u>	<u>\$ 30</u>	<u>\$ 7,597</u>

STATE OF TENNESSEE  
NOTES TO THE FINANCIAL STATEMENTS (Continued)  
JUNE 30, 1998

G. Due From Primary Government To Component Units - A summary of due to the component units from the primary government at June 30, 1998 is shown below (expressed in thousands).

DUE FROM PRIMARY GOVERNMENT	DUE TO COMPONENT UNITS				Totals
	General	Capital Projects	Local Government Group Insurance	Chairs of Excellence	
Northeast CSA	\$ 171		\$ 2		\$ 173
East TN CSA	388				388
Upper Cumberland CSA	240				240
Southeast CSA	31				31
Mid-Cumberland CSA	427		5		432
South Central CSA	184				184
Northwest CSA	332				332
Southwest CSA	24		1		25
Davidson County CSA	56				56
Knox County CSA	154				154
Hamilton County CSA	81				81
Veteran’s Nursing Home	11				11
Tennessee Board of Regents	10			\$ 772	782
University of Tennessee		\$ 624		1,011	1,635
Total	\$ 2,109	\$ 624	\$ 8	\$ 1,783	\$ 4,524

H. Discretely Presented Component Unit – The University of Tennessee Balance Sheet includes Due From and Due To Other Funds of \$10.229 million and \$8.554 million respectively. The \$1.675 million difference is a result of reporting transactions between the University of Tennessee and University Health System, Inc. (UHS). Due to the controlled governance by the university, UHS must be presented as a component unit of the University of Tennessee. The transactions between the university and UHS do not agree in the accompanying financial statements because they have different fiscal year ends. All activity reported for UHS is as of and for the year ended December 31, 1997.

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

I. Due to Component Units From Component Units - A summary of due to the component units from component units at June 30, 1998 is shown below (expressed in thousands).

DUE FROM COMPONENT UNITS	DUE TO COMPONENT UNITS						Totals
	Northwest CSA	Davidson Co. CSA	Shelby Co. CSA	TN State School Bond Authority	Board of Regents	University of Tennessee	
East TN CSA		\$ 1					\$ 1
Southeast CSA			\$ 1				1
Southwest CSA	\$ 1						1
TN State School Bond Authority					\$ 6,601	\$ 17,093	23,694
University of Tennessee				\$ 1,509			1,509
Totals	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 1,509</u>	<u>\$ 6,601</u>	<u>\$ 17,093</u>	<u>\$25,206</u>

J. Advances -

The General Fund has an advance of \$190 thousand to a component unit, the Veterans’ Homes Board. The Veterans’ Homes Board is to repay the advance out of profits generated.

The General Fund has an advance to Baccalaureate Education, an Expendable Trust Fund, for \$940 thousand. Baccalaureate Education is to repay this from administrative fees.

Tennessee State School Bond Authority has made the following advances to other component units (expressed in thousands):

	<u>Advances from Component Units</u>
Tennessee Board of Regents	\$ 98,179
University of Tennessee	<u>241,993</u>
	<u>\$ 340,172</u>

These advances are due in varying amounts annually and are sufficient to pay the debt service on the bonds and notes payable that the Tennessee State School Bond Authority has issued.



**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

K. Accounts and Notes Receivable - Receivables at June 30, 1998 consist of the following (expressed in thousands):

	<u>General</u>	<u>Special Revenue</u>	<u>Debt Service</u>	<u>Capital Projects</u>	<u>Enterprise</u>	<u>Internal Service</u>	<u>Trust and Agency</u>	<u>Total</u>
Accounts Receivable:								
Interest	\$ 11,465				\$ 17		\$183,931	\$ 195,413
Taxes	343,162	\$ 325,138	\$ 3,190				230,872	902,362
Accounts	5,635	198			6,198	\$ 430	97,709	110,170
Intergovernmental	<u>375,146</u>	<u>137,955</u>	<u></u>	<u>\$ 816</u>	<u>254,571</u>	<u>2,789</u>	<u>1,207</u>	<u>772,484</u>
Gross Accounts Receivable	735,408	463,291	3,190	816	260,786	3,219	513,719	1,980,429
Less: Allowance for Uncollectibles	<u></u>	<u></u>	<u></u>	<u></u>	<u></u>	<u></u>	<u>(21,769)</u>	<u>(21,769)</u>
Net Accounts Receivable	<u>\$735,408</u>	<u>\$ 463,291</u>	<u>\$ 3,190</u>	<u>\$ 816</u>	<u>\$ 260,786</u>	<u>\$ 3,219</u>	<u>\$491,950</u>	<u>\$1,958,660</u>

Component Units

	<u>Tennessee Student Assistance Corporation</u>	<u>Tennessee Housing Development Agency</u>	<u>Tennessee Local Development Authority</u>	<u>Board of Regents</u>	<u>University of Tennessee</u>	<u>Other</u>	<u>Total</u>
Accounts Receivable:							
Interest	\$ 296	\$ 22,082	\$ 82	\$ 3,138	\$ 3,805		\$ 29,403
Accounts	18,347	1,213,171	90,937	55,498	194,748	\$ 3,032	1,575,733
Intergovernmental	<u>1,660</u>	<u></u>	<u></u>	<u></u>	<u></u>	<u></u>	<u>1,660</u>
Gross Accounts Receivable	20,303	1,235,253	91,019	58,636	198,553	3,032	1,606,796
Less: Allowance for Uncollectibles	<u></u>	<u></u>	<u></u>	<u>(6,660)</u>	<u>(46,085)</u>	<u></u>	<u>(52,745)</u>
Net Accounts Receivable	<u>\$ 20,303</u>	<u>\$ 1,235,253</u>	<u>\$ 91,019</u>	<u>\$ 51,976</u>	<u>\$ 152,468</u>	<u>\$ 3,032</u>	<u>\$ 1,554,051</u>
Notes Receivable	\$ 5,822			\$ 27,453	\$ 33,238		\$ 66,513
Less: Allowance for Uncollectibles	<u></u>	<u></u>	<u></u>	<u>(6,536)</u>	<u>(1,159)</u>	<u></u>	<u>(7,695)</u>
Net Notes Receivable	<u>\$ 5,822</u>	<u></u>	<u></u>	<u>\$ 20,917</u>	<u>\$ 32,079</u>	<u></u>	<u>\$ 58,818</u>

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

L. Fund Balance Reserves and Designations - Specific purpose reserves represent current and past legislative appropriations requiring year-end segregation. A summary of the nature and purpose of these reserves at June 30, 1998 by fund type follows (expressed in thousands).

	Reserved for <u>Other Specific Purposes</u>	<u>General</u>	Special <u>Revenue</u>	Trust <u>and Agency</u>
Highway Construction			\$145,341	
Wildlife Resources Program			29,165	
Criminal Injuries Compensation			54,230	
Solid Waste			7,091	
Environmental Protection			13,785	
Hazardous Waste Program			8,747	
Parks Acquisition			14,718	
Unemployment Compensation Benefits				\$ 948,773
Pension Benefits				21,057,487
Higher Education Chairs of Excellence				207,428
Local Government Investment Pool				1,450,799
Health Access Incentive		\$ 606		
Commerce and Insurance Regulatory Boards		2,302	2,662	
Health Regulatory Boards		2,706		
Traumatic Brain Injury		1,356		
Sports Authority		3,372		
Other Non-Lapsing and Special Revenue Programs		<u>9,317</u>	<u>19,669</u>	<u>8,693</u>
Totals		<u>\$ 19,659</u>	<u>\$295,408</u>	<u>\$23,673,180</u>

The General Fund designation for other specific purposes represents the following appropriations made by the Legislature to carry out tentative managerial plans for fiscal year 1999 (expressed in thousands):

Future Appropriations	\$ 247,497
Casualty Losses	5,000
Industries for the Blind	<u>132</u>
	<u>\$252,629</u>

The reserve for related assets represents assets which are not available for appropriation. A summary of these reserves at June 30, 1998 by fund type follows (expressed in thousands).

	Reserved for <u>Related Assets</u>	<u>General</u>	Special <u>Revenue</u>
Inventories			\$ 6,458
Advances to Component Units		\$ 190	
Long-Term Receivables		3,106	
Prepayments		23	
		<u>\$ 3,319</u>	<u>\$ 6,458</u>

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

- M. Related Organizations - The State's officials are also responsible for appointing the members of the boards of other organizations, but the State's accountability for these organizations does not extend beyond making appointments. The State appoints the board members of the Beech River Watershed Development Authority, Carroll County Watershed Authority, Goodwyn Institute Commission, Watkins Institute Commission, Tennessee Alliance for Fitness and Health, Tennessee Competitive Export Corporation, Insurance Guaranty Association, Tennessee Sports Hall of Fame, Local Neighborhood Development Corporations, Tennessee Holocaust Commission, Inc., and Sports Festival, Inc.
- N. Joint Ventures -The State is a participant in a joint venture, the Tennessee-Tombigbee Waterway Development Compact, with the states of Alabama, Kentucky and Mississippi. The purpose of this compact is to promote the development of a navigable waterway connecting the Tennessee and Tombigbee Rivers and provide a nine foot navigable channel. The fiscal year end of the Tennessee Tombigbee Waterway is December 31. Financial statements for the Tennessee Tombigbee Waterway may be obtained at: P. O. Drawer 671, Columbus, MS 39703.

Presented below is summary financial data for this joint venture (expressed in thousands):

	<u>1997</u>	<u>1996</u>
Current Assets	\$ 278	\$ 203
Property Plant & Equipment	<u>19</u>	<u>19</u>
Total Assets	<u>297</u>	<u>222</u>
Current Liabilities	2	11
Investment in General Fixed Assets	19	19
Fund Balance	<u>276</u>	<u>192</u>
Total Liabilities and Fund Balance	<u>297</u>	<u>222</u>
Revenues	359	295
Expenditures	<u>275</u>	<u>301</u>
Excess of Revenues over (under) expenditures	84	(6)
Beginning Fund Balance	<u>192</u>	<u>198</u>
Ending Fund Balance	<u>\$ 276</u>	<u>\$ 192</u>

- O. Jointly Governed Organizations - The State in conjunction with 26 other states are members of the Pest Control Compact.

The State in conjunction with 13 other states are members of the Southern Growth Policies Board. Tennessee paid some \$40,917 in fiscal year 1998 for membership dues.

The Southern Regional Education Compact was entered into with 14 other states. Tennessee paid \$8,000 in dues in fiscal year 1998.

The Compact for Education was entered into with 49 other states. Tennessee paid an annual assessment of \$56,000.

The Interstate Mining Compact has 18 member states, including Tennessee. Tennessee paid \$11,215 in fiscal year 1998 for membership dues.

The Southern States Energy Board is comprised of 16 member states, including Tennessee.

The Southeast Interstate Low Level Radioactive Waste Compact has 7 member states.

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

P. Presented below are the condensed financial statements for the discretely presented component units (expressed in thousands):

CONDENSED FINANCIAL STATEMENTS - DISCRETELY PRESENTED COMPONENT UNITS

BALANCE SHEETS

	Tennessee Student Assistance Corporation	Tennessee Housing Develop. Agency	Tennessee Local Develop. Authority	Tennessee State School Bond Authority	Tennessee Board of Regents	University of Tennessee	Other	Total
Assets:								
Current Assets	\$ 80,624	\$ 468,738	\$ 34,341	\$ 10,316	\$ 309,918	\$ 477,495	\$ 18,454	\$1,399,886
Due from Primary Government					782	1,635	2,107	4,524
Due from Component Units				23,694		1,509	3	25,206
Advance to Component Units				340,172				340,172
Other Assets		1,630,752	96,407	48,676	141,083	406,670	2,209	2,325,797
Fixed Assets	209	160			1,867,478	1,829,595	12,695	3,710,137
Amounts to be Provided	83						996	1,079
Total Assets	<u>\$ 80,916</u>	<u>\$ 2,099,650</u>	<u>\$ 130,748</u>	<u>\$ 422,858</u>	<u>\$2,319,261</u>	<u>\$ 2,716,904</u>	<u>\$ 36,464</u>	<u>\$7,806,801</u>
Liabilities:								
Current Liabilities	\$ 5,525	\$ 122,619	\$ 28,807	\$ 96,533	\$ 209,394	\$ 187,047	\$ 9,103	\$ 659,028
Due to Primary Government	6	163			2,742	1,621	3,065	7,597
Due to Component Units				1,509	6,601	17,093	3	25,206
Bonds Payable		1,662,955	90,703	318,696	1,877		5,187	2,079,418
Advance From Primary Government							190	190
Advance from Component Units					98,179	241,993		340,172
Total Liabilities	<u>5,531</u>	<u>1,785,737</u>	<u>119,510</u>	<u>416,738</u>	<u>318,793</u>	<u>447,754</u>	<u>17,548</u>	<u>3,111,611</u>
Equity:								
Investment in General Fixed Assets	209				1,758,399	1,568,150	1,945	3,328,703
Contributed Capital		2,500					10,164	12,664
Retained Earnings	75,176	311,413	11,238	6,120			2,386	406,333
Fund Balances					242,069	701,000	4,421	947,490
Total Equity	<u>75,385</u>	<u>313,913</u>	<u>11,238</u>	<u>6,120</u>	<u>2,000,468</u>	<u>2,269,150</u>	<u>18,916</u>	<u>4,695,190</u>
Total Liabilities and Equity	<u>\$ 80,916</u>	<u>\$ 2,099,650</u>	<u>\$ 130,748</u>	<u>\$ 422,858</u>	<u>\$2,319,261</u>	<u>\$2,716,904</u>	<u>\$ 36,464</u>	<u>\$7,806,801</u>

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

STATEMENTS OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

	Tennessee Student Assistance Corporation	Other	Total
Revenues	\$ 21,453	\$ 3,586	\$ 25,039
Expenditures:			
Current	32,177	41,591	73,768
Transfers (To) Other Funds	(349)		(349)
Transfers From Primary Government	<u>21,069</u>	<u>38,524</u>	<u>59,593</u>
Excess of Revenues and Other Financing Sources Over (Under) Expenditures	9,996	519	10,515
Fund Balances, July 1	<u>65,180</u>	<u>3,902</u>	<u>69,082</u>
Fund Balances, June 30	<u>\$ 75,176</u>	<u>\$ 4,421</u>	<u>\$ 79,597</u>

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN EQUITY

	Tennessee Housing Develop. Agency	Tennessee Local Develop. Authority	Tennessee School Bond Authority	Other	Total
Operating Revenues	\$ 163,420	\$ 7,147	\$ 22,270	\$ 9,742	\$ 202,579
Operating Expenses	<u>115,403</u>	<u>5,363</u>	<u>21,623</u>	<u>9,045</u>	<u>151,434</u>
Operating Income (Loss)	48,017	1,784	647	697	51,145
Non-Operating Revenues (Expenses)	8,662			(55)	8,607
Transfers From Primary Government		25			25
Transfer (to) Primary Government	(43,000)				(43,000)
Extraordinary Items	<u>(119)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(119)</u>
Net Income (Loss)	13,560	1,809	647	642	16,658
Contributed Capital				5	5
Fund Equity, July 1	282,236	9,436	5,422	11,903	308,997
Cumulative Effect of Change in Accounting Principle	<u>18,117</u>	<u>(7)</u>	<u>51</u>	<u>—</u>	<u>18,161</u>
Fund Equity, June 30	<u>\$ 313,913</u>	<u>\$ 11,238</u>	<u>\$ 6,120</u>	<u>\$ 12,550</u>	<u>\$ 343,821</u>

STATE OF TENNESSEE  
NOTES TO THE FINANCIAL STATEMENTS (Continued)  
JUNE 30, 1998

STATEMENTS OF CURRENT FUNDS REVENUES, EXPENDITURES AND OTHER CHANGES

	Tennessee Board of <u>Regents</u>	University of <u>Tennessee</u>	<u>Total</u>
Revenues	\$ 610,918	\$ 873,464	\$ 1,484,382
Expenditures:			
Education and General	1,028,314	799,769	1,828,083
Auxiliary Enterprise and Hospital	68,007	374,355	442,362
Transfers To Other Colleges and University Funds	(23,802)	(63,396)	(87,198)
Transfers From Primary Government	522,889	359,857	882,746
Other Additions (Deductions)	<u>(43)</u>	<u>4,558</u>	<u>4,515</u>
Net Increase (Decrease) in Fund Balances	<u>\$ 13,641</u>	<u>\$ 359</u>	<u>\$ 14,000</u>

Q. Individual Fund Deficits - The following individual funds have deficit retained earnings/fund balances at June 30, 1998 (expressed in thousands):

Capital Projects	\$ (33,106)
Enterprise Funds:	
Property Utilization	\$ (1,610)
Internal Service Funds:	
Food Services	\$ (2,153)
Central Stores	\$ (243)
Legislative Services	\$ (34)
Component Units:	
Veteran's Home Board	\$ (962)
Child Care Facilities	\$ (179)
University of Tennessee Unexpended Plant	\$ (10,570)

The deficit in the capital projects fund will be eliminated as the State sells general obligation bonds to finance the various construction contracts encumbered. Increases in fees and charges for services and products are expected to eliminate the deficits in the other funds in fiscal years 1999 and beyond.

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

**NOTE 3 – LONG-TERM LIABILITIES AND CERTAIN OTHER OBLIGATIONS**

A. Bonds Payable - Bonds Payable at June 30, 1998 are shown below (expressed in thousands).

	<u>Bonds</u>
<u>Enterprise Funds:</u>	
General obligation bonds, 5.0% to 7.5%, due in generally decreasing amounts of principal and interest ranging from \$2.6 million in 2002 to \$719 thousand in 2006	\$ 13,825
General obligation refunding bonds, 1996 Series C, 4.6% to 5.0% principal and interest due in amounts ranging from \$1.8 million in 1999 to \$986 thousand in 2010	<u>12,780</u>
Total Enterprise Funds	<u>26,605</u>
<u>Internal Service Funds:</u>	
General obligation bonds, 4.4% to 7.0%, due in decreasing amounts of principal and interest from \$15.1 million in 1999 to \$273 thousand in 2018	125,935
General obligation refunding bonds, 1996 Series B, 4.6% to 6% principal and interest due in amounts ranging from \$2.1 million in 2002 to \$352 thousand in 2011	<u>13,449</u>
Total Internal Service Funds	<u>139,384</u>
<u>General Long-Term Debt:</u>	
General obligation bonds, 4.4% to 7.0%, due in decreasing amounts of principal and interest from \$79.2 million in 1999 to \$1.8 million in 2027	667,069
General obligation refunding bonds, 1991 Series A, 6% to 6.35% principal and interest due in amounts ranging from \$6.5 million in 1999 to \$5.6 million in 2002	20,900
General obligation refunding bonds, 1996 Series B, 4.6% to 6% principal and interest due in amounts ranging from \$21.4 million in 2002 to \$3.6 million in 2011	<u>138,851</u>
Total General Long-Term Debt	<u>826,820</u>
Total Bonds Payable	<u>\$ 992,809</u>

Bond sales during the year ended June 30, 1998 included the following issue:

May 1998 - General obligation bonds of \$120.6 million.

The May 1998 \$120.6 million general obligation bond issue above represents bonds maturing serially through 2018 at an interest rate of 5%. Proceeds of \$62.0 million were used to redeem bond anticipation notes on June 1, 1998.

In prior years, the state defeased certain general obligation bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and liability for the defeased bonds are not included in the General Long-Term Obligations Account Group. However, since the State Treasurer is holding these monies in a trustee capacity, the assets and an offsetting liability are reported in an agency fund. As of June 30, 1998, \$73 million of bonds outstanding are considered defeased.

B. Notes Payable - Notes payable at June 30, 1998 are shown below (expressed in thousands).

	<u>Notes</u>
<u>General Long-Term Debt:</u>	
General Obligation bond anticipation notes, variable rate, due July 2001	\$ 92,850
<u>Internal Service Funds:</u>	
General Obligation bond anticipation notes, variable rate, due July 2001	<u>46,250</u>
Total Notes Payable	<u>\$ 139,100</u>

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

The full faith and credit of the state, together with certain tax revenues, are pledged to secure all general obligation bonds and bond anticipation notes listed above. Although the Enterprise (State Loan Program) and Internal Service Fund (Facilities Revolving Fund, Office of Information Resources, Motor Vehicle Management, and Equipment Revolving Fund) general obligation debt is being retired from resources of those funds, the state remains contingently liable for its payment.

In April 1996, the State instituted a general obligation bond anticipation note program for authorized capital projects. Under this program, notes may be issued from time to time as required; however, generally only \$250 million may be outstanding at any time. The notes bear interest for a weekly rate period, and will continue to do so unless adjusted to a different rate period. During the weekly rate period, the notes will be subject to tender for purchase upon notice to the tender agent. The State has entered into a Standby Note Purchase Agreement with the Tennessee Consolidated Retirement System (“TCRS”) under which TCRS is obligated to pay the purchase price of any note tendered for optional or mandatory purchase and not remarketed. The obligation of TCRS to purchase tendered unremarketed notes is subject to suspension or termination upon certain events. Unless terminated early, the Standby Note Purchase Agreement will terminate on July 2, 2001, the stated maturity of the program.

C. Debt Service Requirements to Maturity - It is the state's intention to retire substantially all notes payable at June 30, 1998 within one year. Debt Service requirements to maturity for all general obligation bonds payable at June 30, 1998 are as follows (expressed in thousands):

For the Year(s) <u>Ended June 30</u>	<u>General Obligation Bonds</u>		Total <u>Requirements</u>
	<u>Principal</u>	<u>Interest</u>	
1999	\$ 73,215	\$ 52,709	\$ 125,924
2000	73,970	48,931	122,901
2001	71,805	45,117	116,922
2002	71,815	41,249	113,064
2003	66,020	37,412	103,432
2004-2008	297,824	133,325	431,149
2009-2013	219,460	64,062	283,522
2014-2018	106,525	16,330	122,855
2019-2023	6,035	2,720	8,755
2024-2027	6,140	867	7,007
	<u>\$992,809</u>	<u>\$442,722</u>	<u>\$ 1,435,531</u>



**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

D. Changes in General Long-Term Obligations - A summary of changes in general long-term obligations for the year ended June 30, 1998 follows (expressed in thousands).

	Balance, July 1, 1997	General Obligation Debt <u>Issued</u>	General Obligation Debt <u>Retired</u>	Other Changes in General Long-Term <u>Obligations</u>	Balance, June 30, 1998
General Obligation Bonds Payable	\$ 767,098	\$ 114,995	\$ (55,273)		\$ 826,820
General Obligation Notes Payable	114,885	37,612	(59,647)		92,850
Claims Payable	100,099			\$ 71,348	171,447
Accrued Annual and Compensatory Leave	123,560			5,645	129,205
Lease Obligation Payable	631			(43)	588
Total General Long Term Obligations	<u>\$1,106,273</u>	<u>\$ 152,607</u>	<u>\$ (114,920)</u>	<u>\$ 76,950</u>	<u>\$1,220,910</u>

The \$171.447 million above for Claims Payable represents the long-term obligation of \$140.767 million for Underground Storage Tanks, a Special Revenue Fund; \$20 million from Highway Fund, a Special Revenue Fund; and \$10.68 million payable from the General Fund.

Some \$5.605 million in bonds payable and \$13.388 million in notes payable were issued to finance construction projects for facilities owned by the Facilities Revolving Fund, an Internal Service fund. These notes payable and bonds payable are reported as a liability of the Facilities Revolving Fund which is responsible for paying the debt service. These construction projects were managed by the Capital Projects Fund.

E. General Obligation Bonds Authorized and Unissued - A summary of general obligation bonds authorized and unissued at June 30, 1998 is shown below (expressed in thousands). It is anticipated that a significant amount of these bonds will not be issued but will be canceled because of sufficient fund balances.

<u>Purpose</u>	Unissued July 1, 1997	<u>Authorized</u>	<u>Sold</u>	<u>Canceled</u>	Unissued June 30, 1998
Highway	\$ 726,100	\$ 90,000		\$ 79,800	\$ 736,300
Education	47,143		\$ 13,663		33,480
Environment and Conservation	83,098		19,840		63,258
General Government	483,069	265,500	86,982	6,148	655,439
Local Development Authority		27,000			27,000
Other	<u>1,240</u>	<u>          </u>	<u>115</u>	<u>625</u>	<u>500</u>
Totals	<u>\$ 1,340,650</u>	<u>\$ 382,500</u>	<u>\$ 120,600</u>	<u>\$ 86,573</u>	<u>\$ 1,515,977</u>

STATE OF TENNESSEE  
NOTES TO THE FINANCIAL STATEMENTS (Continued)  
JUNE 30, 1998

F. Capital Lease Obligations – The State leased a building for a vocational training center. The lease provides an option to purchase the building within the twelve year lease period. Capital lease obligations are payable from resources of the General Fund. The property has been reported in the General Fixed Assets Account group as follows:

	<u>1998</u>
Land	\$ 56,000
Building	\$605,000

At June 30, 1998, minimum annual lease payments are as follows (expressed in thousands):

<u>For the Year(s)</u> <u>Ended June 30</u>	<u>Lease</u> <u>Obligation Payable</u>
1999	\$ 74
2000	74
2001	74
2002	74
2003	74
2004-2008	370
2009	<u>18</u>
Total	758
<u>Less</u> - Interest (5.1%)	<u>170</u>
Present value of net minimum lease payments	<u>\$588</u>

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

G. Component Units -Tennessee Housing Development Agency (THDA):

Bonds Payable and Notes at June 30, 1998, are shown below (expressed in thousands):

Revenue Bonds Payable - Tennessee Housing Development Agency mortgage finance program revenue bonds, various Series, 3.5% to 8.5%, due in amounts of principal and interest ranging from \$273.9 million in 1999 to \$3 million in 2029	\$1,667,682
Less: Unamortized bond refunding costs	<u>4,727</u>
Net Bonds Payable	<u>\$1,662,955</u>
THDA Single Family Mortgage Notes Trust Indenture, variable monthly interest rate, due December 1998	<u>\$ 47,755</u>

The revenue bonds listed above are not obligations of the state. They are secured by pledge of resources from the facilities to which they relate and by certain other revenues, fees and assets of the Tennessee Housing Development Agency (THDA).

Debt service requirements to maturity for these revenue bonds payable at June 30, 1998, are as follows (expressed in thousands):

For the Year(s) Ended June 30	Revenue Bonds		Total Requirements
	Principal	Interest	
1999	\$ 180,287	\$ 93,597	\$ 273,884
2000	36,471	87,872	124,343
2001	36,033	86,886	122,919
2002	37,970	85,137	123,107
2003	40,108	83,227	123,335
2004-2008	245,577	402,439	648,016
2009-2013	254,654	337,031	591,685
2014-2018	299,469	252,069	551,538
2019-2023	326,603	116,050	442,653
2024-2028	191,122	18,482	209,604
2029	3,085	61	3,146
	<u>\$1,651,379</u>	<u>\$1,562,851</u>	<u>\$ 3,214,230</u>

The above principal for revenue bonds is less than that presented on the accompanying financial statements by \$11.576 million. Of this amount, \$16.303 million represents accretion to date of interest on deep discount bonds in those years preceding the first principal payment on these bonds. This accretion has been reported above as interest in the years on which the bonds mature (1999-2017). In addition, \$4.727 million, which is a deduction from bonds payable for the deferred amount on refundings, is not reflected in the above presentation.

Bond sales during the year ended June 30, 1998 included the following issues:

- August 1997 - THDA program bonds of \$60 million.
- October 1997 - THDA program bonds of \$88.008 million.
- February 1998 - THDA program bonds of \$57.885 million.
- June 1998 - THDA program bonds of \$100 million.

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

In August 1997, THDA remarketed \$60 million in Homeownership Program bonds. Remarketed issue 1996-5A resulted in \$8.18 million of bonds maturing serially through 2012 at interest rates ranging from 4% to 5.35%, \$4.825 million term bonds maturing in July 2017 at 5.5%, \$7.935 million term bonds maturing in July 2023 at 5.55%, and \$9.06 million term bonds maturing in July 2028 at 5.75%. Remarketed issue 1996-5B resulted in \$30 million of convertible option bonds at 3.85% which may be called between March 1998 and August 1998.

On October 9, 1997, THDA issued \$88.008 million in Homeownership Program bonds which was used to refund \$88.01 million in bonds previously issued in the Homeownership Program. The carrying amount of those bonds was \$86.887 million. A call premium of \$1.88 million was paid on the redemption. The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$3.003 million. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2016 using the straight-line method. THDA completed the refunding to reduce its total debt service over the next 18 years by \$2.378 million and realized an economic gain (the difference between the present value of the old and new debt service payments) of \$17.54 million.

The February 1998 THDA bond issue above represents remarketed \$57.885 million in Homeownership Program bonds. The issue, used to refund 1997-1 convertible option bonds, represents \$16.385 million of bonds maturing serially through 2012 at interest rates ranging from 4% to 5.1%, \$9.695 million term bonds at 5% due 2017, \$15.845 million of term bonds at 5.375% due 2023, and \$15.96 million in bonds maturing in 2028 at 5.4%. THDA completed the refunding to reduce its total debt over the next 24 years by \$24,769,152 and realized an economic gain (the difference between the present value of the old and new debt service payments) of \$19,498,872.

On June 4, 1998, THDA issued \$50 million in Homeownership Program Convertible Option Bonds. \$40.93 million was used for refunding bonds outstanding in the Mortgage Finance Program and the Homeownership Program on July 1, 1998. Also, on June 4, 1998, THDA remarketed \$50 million in Homeownership Program bonds. The issue was used to refund 1997-2 convertible option bonds. The issue resulted in convertible option bonds at 3.7% which may be called between November 19, 1998 and March 4, 1999.

THDA Bonds Payable were retired at par before maturity in the year ended June 30, 1998, in the Mortgage Finance Program Bonds in the amount of \$370 million and in the Homeownership Program Bonds in the amount of \$14.225 million. The respective carrying values of these bonds were \$366.419 million and \$14.11 million. This resulted in a loss to the Mortgage Finance Program of \$3.581 thousand and the Homeownership Program of \$115 thousand. This loss is classified as an extraordinary loss.

Under the bond resolutions, the Agency has the option to redeem bonds at an initial price of 103 percent and subsequently at prices declining to par. Generally, the redemption option cannot be exercised prior to the time the bonds have been outstanding for ten years. Certain special redemption options, as governed by the bond resolutions, are permitted prior to that time. The bonds are secured, as described in the applicable bond resolutions, by the revenues, monies, investments, mortgage loans, and other assets in the funds and accounts established by the resolutions.

The Single Family Mortgage Notes Trust Indenture, dated December 1, 1997 (the "Trust Indenture"), provides for the issuance of Agency draw-down notes with a current maximum aggregate principal amount of \$65 million. The Notes bear interest, payable on the first Thursday of each succeeding month with respect to the principal amount drawn by the agency. The interest rate is equal to ninety percent (90%) of the bond equivalent yield as determined on the related rate date. On January 1, 1998, the initial principal amount of \$47.755 million was drawn to refund \$47.755 million in bonds previously issued in the Mortgage Finance Program and the Homeownership Program (\$45.535 million early redemptions and \$2.22 million current maturities). The carrying amount of the bonds was \$47.341 million. The refunding resulted in a difference of \$414 thousand between the reacquisition price and the net carrying amount of the old debt. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2026. The refunding was accomplished using proceeds of short-term debt, which will in turn be refunded on maturity; therefore, the full economic impact of these refundings was not determined as of June 30, 1998.

STATE OF TENNESSEE

NOTES TO THE FINANCIAL STATEMENTS (Continued)

JUNE 30, 1998

H. Component Units - Tennessee Local Development Authority (TLDA)

Bonds Payable and Notes Payable at June 30, 1998, are shown below (expressed in thousands):

Tennessee Local Development Authority revenue bonds, 2.5% to 7.25%, due in generally decreasing amounts of principal and interest from \$10.5 million in 1999 to \$.3 million in 2024	\$92,492
Less: unamortized bond refunding costs	<u>1,789</u>
Net Bonds Payable	<u>90,703</u>
Tennessee Local Development Authority revenue bond anticipation notes, \$26.059 million at 3.69% due May 1999	\$26,059

The revenue bonds and notes listed above are not obligations of the state. They are secured by pledge of resources from the facilities to which they relate and by certain other revenues, fees and assets of the Tennessee Local Development Authority (TLDA).

Debt Service requirements to maturity for TLDA’s revenue bonds payable at June 30, 1998 are as follows (expressed in thousands):

For the Year(s) Ended June 30	Revenue Bonds		Total Requirements
	Principal	Interest	
1999	\$ 5,419	\$ 5,096	\$ 10,515
2000	5,699	4,812	10,511
2001	4,883	4,557	9,440
2002	5,159	4,280	9,439
2003	5,184	4,014	9,198
2004-2008	23,453	15,998	39,451
2009-2013	22,751	9,606	32,357
2014-2018	15,142	3,686	18,828
2019-2023	4,547	721	5,268
2024	255	8	263
	<u>\$ 92,492</u>	<u>\$ 52,778</u>	<u>\$ 145,270</u>

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

I. Component Units - Tennessee State School Bond Authority (TSSBA)

Bonds and Notes Payable at June 30, 1998 are shown below (expressed in thousands).

Tennessee State School Bond Authority revenue bonds, various Series, 3% to 6.0%, due in decreasing amounts of principal and interest from \$11.3 million in 1999 to \$4.7 million in 2026	\$ 109,732
Tennessee State School Bond Authority 1972 Refunding Revenue bonds, maturing 2005	18,340
Tennessee State School Bond Authority 1977 Refunding Revenue bonds, maturing 2011	30,258
Tennessee State School Bond Authority 1985 Tax-Exempt Exchangeable Securities, maturing to 2015	25,947
Tennessee State School Bond Authority 1987 Refunding Revenue bonds, maturing to 2012	5,250
Tennessee State School Bond Authority 1989 Current Interest and College Savings Bonds, Maturity 2020	27,122
Tennessee State School Bond Authority 1990 Series A Taxable and Series B Tax Exempt Revenue Bonds, Maturity 2011	6,195
Tennessee State School Bond Authority 1992 Series A Tax-Exempt Revenue Bonds, Maturity 2022	40,775
Tennessee State School Bond Authority 1996 Refunding Revenue Bonds, maturing to 2020	<u>57,305</u>
 Bonds Payable	 320,924
 Less: Unamortized bond refunding costs	 <u>(2,228)</u>
Net Bonds Payable	<u>318,696</u>
 Tennessee State School Bond commercial paper, variable rate	 <u>\$ 91,750</u>

The revenue bonds and commercial paper listed above are not obligations of the state. They are secured by pledge of resources from the facilities to which they relate and by certain other revenues, fees and assets of the Tennessee State School Bond Authority (TSSBA).

Debt Service requirements to maturity for TSSBA’s revenue bonds payable at June 30, 1998 are as follows (expressed in thousands):

For the Year(s) Ended June 30	Revenue Bonds		Total Requirements
	Principal	Interest	
1999	\$ 19,738	\$ 18,417	\$ 38,155
2000	19,397	17,549	36,946
2001	17,706	16,446	34,152
2002	18,398	15,632	34,030
2003	17,172	14,752	31,924
2004-2008	79,793	60,951	140,744
2009-2013	64,746	36,447	101,193
2014-2018	33,877	17,242	51,119
2019-2023	27,418	8,123	35,541
2024-2026	12,604	1,456	14,060
	<u>\$310,849</u>	<u>\$207,015</u>	<u>\$ 517,864</u>

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

The above principal for revenue bonds is less than that presented on the accompanying financial statements by \$7.847 million. Of this amount, \$10.075 million represents accretion to date of interest on deep discount bonds in those years preceding the first principal payment on these bonds. This accretion has been reported above as interest in the years on which the bonds mature (1999-2010). In addition, \$2.228 million, which is a deduction from bonds payable for the deferred amount on refundings is not reflected in above presentation.

Commercial Paper Program. The Tennessee State School Bond Authority authorized the issuance of \$150 million in commercial paper on November 18, 1997. During fiscal year ending 1998, \$91.75 million of commercial paper was issued through J. P. Morgan and Company, dealer, to finance costs of various capital projects and to refinance certain outstanding bond anticipation note indebtedness. Of the commercial paper outstanding at June 30, 1998, \$87.5 million was tax-exempt and \$4.25 million was federally taxable.

The commercial paper is a special obligation of the Authority. The proceeds of the sale of commercial paper may be used to pay the principal of previously issued commercial paper. Commercial paper principal and interest may be paid from: (i) the proceeds of draws on the Liquidity Facility, (ii) Available Revenues, (iii) the moneys and securities (if any) on deposit in the commercial paper and reimbursement account and in the Debt Service Fund, (iv) the moneys and securities (if any) on deposit in the Project Construction Account for such projects, and (v) the proceeds of bonds, notes or other evidences of indebtedness to the extent set aside to make such payments.

The maturity of the paper may not exceed 270 days and the maximum interest rate may not exceed 12%. Upon maturity, the paper is remarketed by the commercial paper dealer, redeemed, or extinguished with long-term debt.

The liquidity provider, under an Advance Agreement, is Union Bank of Switzerland. The total available commitment is \$152,250,000. The commitment fees are 8 basis points on the unused portion of the commitment and 8.5 basis points on the used portion paid quarterly in arrears. The interest rate paid on any Advance made by the bank (i) from the Advance Date to and including the 30<sup>th</sup> day following the Advance Date is the greater of (a) Fed Funds plus 100 basis points and (b) Prime Rate, (ii) from and including the 31<sup>st</sup> day following the Advance Date to and including the 90<sup>th</sup> day following the Advance Date, the greater of (a) Fed Funds plus 200 basis points and Prime Rate plus 100 basis points, and (iii) after the 90<sup>th</sup> day following the Advance Date, the greater of (a) Fed Funds plus 300 basis points and (b) Prime Rate plus 200 basis points. On any Business Day and with the appropriate notice, the Authority may prepay any Bank Note(s) issued as the result of an advance without penalty. As of June 30, 1998, no Advances had been made under the agreement. The commitment expires at the close of business on November 17, 2000.

Retired Notes Program. Interim and short-term financing for various projects was secured through the Tennessee State School Bond Authority from a Bond Anticipation Notes Program (BANs) through November 30, 1997. The final maturity of the notes was March 1, 1998; however, the notes were retired December 1, 1997, and redeemed with proceeds of the Commercial Paper Program.

**NOTE 4 - INSURANCE RELATED ACTIVITIES**

- A. Teacher Group Insurance - The Teacher Group Insurance Fund, a public entity risk pool, was established in January 1986 to provide a program of health insurance coverage for the teachers of the political subdivisions of the state. In accordance with Tennessee Code Annotated 8-27-302 all local education agencies are eligible to participate. Fund members at June 30, 1998, included 114 local education agencies and two education cooperatives, with 33,871 teachers and support personnel, and 1,629 retirees enrolled in one of three health care options: preferred provider plan, point of service plan, or a health maintenance organization. The state does not retain any risk for losses by this fund.

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

The Teacher Group Insurance Fund assumes responsibility for: determining plan benefits and eligibility, establishing premiums sufficient to fund plan obligations, recording and reporting financial transactions accurately, reporting enrollment to vendors, processing of claims submitted for services provided to plan participants, communicating with plan participants, and complying with appropriate state and federal law and regulation. Plan participants are required to: pay premium on time, file claims for services received, report changes in eligibility of themselves or their dependents, and insure that only eligible expenses are paid by the plan. Individuals who cancel coverage may be required to demonstrate insurability to rejoin the plan. Employers must wait twenty-four months before rejoining the plan should the employer elect to withdraw from the plan. In the case of individuals or groups rejoining the plan, a preexisting condition exclusion currently applies.

The Teacher Group Insurance Fund establishes claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. Teachers and providers have 13 months to file medical claims. The process used to compute claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates, which are 16.5% of the prior 12 months claims. Adjustments to claims liabilities are charged or credited to expense in the period in which they are made. The Teacher Group Insurance Fund considers investment income in determining if a premium deficiency exists.

As discussed above, the Teacher Group Insurance Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities during the past two years (expressed in thousands):

	<u>1998</u>	<u>1997</u>
Unpaid Claims at Beginning of Year	\$ 15,017	\$14,001
Incurred Claims, Provision for Insured Events of the Current Year	<u>79,297</u>	<u>86,086</u>
Total Incurred Claims Expenses	94,314	100,087
Payments	<u>81,051</u>	<u>85,070</u>
Total Unpaid Claims at End of the Year	<u>\$ 13,263</u>	<u>\$ 15,017</u>

- B. Local Government Group Insurance - The Local Government Group Insurance Fund, a public entity risk pool, was established in July 1991 to provide a program of health insurance coverage for employees of local governments and quasi-governmental organizations that were established for the primary purpose of providing services for or on the behalf of state and local governments. In accordance with Tennessee Code Annotated 8-27-207 all local governments and quasi-governmental organizations described above are eligible to participate. Fund members at June 30, 1998, included 33 counties, 65 municipalities and 148 quasi-governmental organizations, with 10,204 employees and 137 retirees maintaining coverage through one of three options: preferred provider plan, point of service plan, or a health maintenance organization. The state does not retain any risk for losses by this fund.

The Local Government Group Insurance Fund assumes responsibility for: determining plan benefits and eligibility, establishing premiums sufficient to fund plan obligations, recording and reporting financial transactions accurately, reporting enrollment to vendors, the processing of claims submitted for services provided to plan participants, communicating with plan participants, and complying with appropriate state and federal law and regulation. Plan participants are required to: pay premium on time, file claims for services received, report changes in eligibility of themselves or their dependents, and insure that only eligible expenses are paid by the plan. Individuals who cancel coverage may be required to demonstrate insurability to rejoin the plan. Employers must wait twenty-four months before rejoining the plan should the employer elect to withdraw from the plan. In the case of individuals or groups rejoining the plan, a preexisting condition exclusion currently applies.



**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

The Local Government Group Insurance Fund establishes claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims. The process used to compute claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates, which are 16% of the prior 12 months claims. Adjustments to claims liabilities are charged or credited to expense in the period in which they are made. The Local Government Group Insurance Fund considers investment income in determining if a premium deficiency exists.

As discussed above, the Local Government Group Insurance Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities during the past two years (expressed in thousands):

	<u>1998</u>	<u>1997</u>
Unpaid Claims at Beginning of Year	\$ 4,251	\$ 5,618
Incurred Claims, Provision for Insured Events of the Current Year	<u>19,499</u>	<u>23,673</u>
Total Incurred Claims Expenses	23,750	29,291
Payments	<u>20,518</u>	<u>25,040</u>
Total Unpaid Claims at End of the Year	<u>\$ 3,232</u>	<u>\$ 4,251</u>

- C. Risk Management - It is the policy of the state not to purchase commercial insurance for the risks of losses for general liability, automobile liability, professional malpractice and workers' compensation. The state management believes it is more economical to manage its risks internally and set aside assets for claim settlement in its internal service fund, the Claims Award Fund (CAF). CAF services claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. All agencies and authorities of the state participate in CAF, except for the Supreme Court Boards, The Dairy Promotion Board, TN 200 (a component unit), and Certified Cotton Grower's Organization (a component unit). CAF allocates the cost of providing claims servicing and claims payment by charging a premium to each agency based on a percentage of each organization's expected loss costs which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of each fiscal year end to determine the fund liability and premium allocation.

CAF liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process does not result in an exact amount. Claims liabilities are reevaluated annually to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. At June 30, 1998 the amount of these liabilities was \$55.664 million, which are discounted at 5.82%. Changes in the balances of claims liabilities during fiscal years 1997 and 1998 were as follows (expressed in thousands):

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

	Beginning of Fiscal Year <u>Liability</u>	Current Year Claims and <u>Changes in Estimates</u>	Claim <u>Payments</u>	Balance at Fiscal <u>Year-End</u>
1996-97	\$ 51,610	\$ 18,774	\$ (16,922)	\$ 53,462
1997-98	\$ 53,462	\$ 21,645	\$ (19,443)	\$ 55,664

At June 30, 1998, CAF held \$83.7 million in cash and cash equivalents designated for payment of these claims.

The state purchases commercial insurance for real property losses above \$5 million per year and surety bond coverage on the state's officials and employees. In the past three fiscal years the state has not had any claims filed with the commercial insurer. A designation for casualty losses in the amount of \$5 million has been established in the General Fund to provide for any property losses other than the commercial insurance coverage.

D. Employee Group Insurance - The Employee Group Insurance Fund, an entity other than a pool, was established in 1979 to provide a program of health insurance coverage for the employees of the state with the risk retained by the state, therefore it is accounted for as an Internal Service Fund. In accordance with Tennessee Code Annotated 8-27-201 all state employees, retirees, and former employees with work related injuries are eligible to participate. Fund members at June 30, 1998, included 63,388 employees and 4,785 retirees enrolled in one of three options: preferred provider plan, point of service plan, or Health Maintenance Organization.

The Employee Group Insurance Fund establishes claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims. The process used to compute claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates, which are 17% of the prior 12 months claims. Adjustments to claims liabilities are charged or credited to expense in the period in which they are made. The Employee Group Insurance Fund considers investment income in determining if a premium deficiency exists.

As discussed above, the Employee Group Insurance Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities during the past two years (expressed in thousands):

	<u>1998</u>	<u>1997</u>
Unpaid Claims at Beginning of Year	\$ 33,243	\$ 33,176
Incurred Claims, Provision for Insured Events of the Current Year	<u>188,288</u>	<u>184,062</u>
Total Incurred Claims Expenses	221,531	217,238
Payments	<u>188,398</u>	<u>183,995</u>
Total Unpaid Claims at End of the Year	<u>\$ 33,133</u>	<u>\$ 33,243</u>

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

**NOTE 5 - PENSION PLANS**

- A. State Defined Benefit Plan - The State of Tennessee contributes to the State Employees, Teachers, and Higher Education Employees Pension Plan (SETHEEPP), a cost-sharing multiple employer defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS) and consisting of 142 participating employers. The TCRS provides retirement benefits as well as death and disability benefits to plan members and their beneficiaries. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the plan on or after July 1, 1979 are vested after five years of service. Members joining prior to July 1, 1979 are vested after four years of service. Benefit provisions are established by state statute found in Title 8, Chapters 34-37 of the Tennessee Code Annotated (TCA). State statutes are amended by the Tennessee General Assembly. Cost of living adjustments (COLA) are provided each July based on the percentage change in the Consumer Price Index (CPI) during the previous calendar year. No COLA is granted if the CPI increases less than one percent. The maximum annual COLA is capped at three percent.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report may be obtained by writing to the Tennessee Treasury Department, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, TN 37243-0230 or by calling (615) 741-7063.

Plan members are noncontributory. The State of Tennessee is required to contribute at an actuarially determined rate. The current rate is 3.65% of annual covered payroll. The contribution requirements of the State of Tennessee are established and may be amended by the TCRS Board of Trustees. The State's contributions to TCRS for the years ending June 30, 1998, 1997, and 1996 were \$166.756 million, \$278.417 million and \$290.222 million respectively, equal to the required contributions for each year.

- B. Political Subdivision Defined Benefits Plan - TCRS administers the Political Subdivision Pension Plan (PSPP), which is an agent multiple-employer defined benefit pension plan that covers employees of 365 participating political subdivisions. The PSPP provides retirement benefits as well as death and disability benefits to plan members and their beneficiaries. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the plan prior to July 1, 1979 are vested after four years of service. Members joining on or after July 1, 1979 are vested upon completion of 10 years of service, unless five years vesting is authorized by resolution of the chief governing body. Benefit provisions are established and amended by state statute. Cost of living adjustments, if adopted by a political subdivision, are provided each July based on the percentage change in the Consumer Price Index (CPI) during the previous calendar year. No COLA is granted if the CPI increases less than one percent. The maximum annual COLA is capped at three percent. Pursuant to Article Two, Section 24 of the Constitution of the State of Tennessee, the state cannot mandate costs on local governments. Any benefit improvement may be adopted by the governing body of a governmental entity participating in the TCRS.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for PSPP. The PSPP report may be obtained by writing to the Tennessee Treasury Department, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, TN 37243-0230 or by calling (615) 741-7063.

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
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- C. Defined Contribution Plan - The Optional Retirement Plan (ORP) as administered by the Tennessee Treasury Department is a defined contribution plan. The ORP was established by state statute in Title 8, Chapter 35, Part 4 of the TCA. This statute also sets out the plan provisions. State statutes are amended by the Tennessee General Assembly. The ORP was designed to provide benefits at retirement to faculty and staff of the Tennessee Board of Regents institutions and the University of Tennessee system who are exempt from the overtime provision of the Fair Labor Standards Act and who waive membership in the TCRS. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Plan members are noncontributory. The State of Tennessee contributes 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Members are fully vested upon entry into the plan. The required contributions made by the State of Tennessee to the ORP were \$47.6 million for the year ending June 30, 1998.
- D. Deferred Compensation - The state offers its employees two deferred compensation plans, one established pursuant to IRC Section 457 and the other pursuant to IRC Section 401 (k). All costs of administering and funding these programs are the responsibility of plan participants.

Section 457 plan balances have been reported in the accompanying financial statements in an Agency Fund at June 30, 1998. All amounts of compensation deferred under this plan, all property purchased with those amounts, and all income attributable thereto are, until paid or made available to the employee or other beneficiary, solely the property of the state, subject only to claims of the state's general creditors. Participants' rights under the plan are the same as those of general creditors in an amount equal to the fair market value of their deferred accounts. The state has no liability for losses under the plan but does have the duty of due care that would be required of an ordinary prudent investor. The state believes it is unlikely that it will use these assets to satisfy such claims in the future.

Since Section 401(k) plan assets remain the property of the contributing employees, they are not presented in the accompanying financial statements. IRC Section 401 (k) establishes participation, contribution and withdrawal provisions for the plan. During the year ended June 30, 1998, contributions totaling \$26.5 million were made by employees participating in the plan. Another \$4.57 million was contributed by the State as matching contributions up to \$20 per employee per month.

**NOTE 6 - POST EMPLOYMENT HEALTH INSURANCE BENEFITS**

- A. General - The state offers an opportunity to its employees and eligible retirees to participate in a self-insured indemnity policy, a point of service plan, or health maintenance organizations. This post employment benefit is authorized under Tennessee Code Annotated 8-27-205. The indemnity policy (preferred provider plan) provides benefits to plan participants in a comprehensive, major medical format involving a \$200 calendar year deductible and a \$1,000 per individual out-of-pocket limit. The plan incorporates typical provisions relating to utilization review, medical necessity, pre-existing conditions, coordination of benefits and subrogation of expenses. The plan offers benefit incentives for the use of designated providers and the plan maintains limitations on benefits provided for the treatment of mental illness and substance abuse.
- B. Retirees - Retirees who are not yet eligible for Medicare benefits may continue participation in the plan subject to certain length of service and participation requirements. Upon Medicare eligibility, the retiree is afforded the opportunity to participate in a fully-insured supplement policy not associated with the plan. The state pays a service determined amount for retirees who participate in the state sponsored Medicare supplement policy.

The funds collected for the plan's operation are recorded in the employee group insurance account. The plan's premiums are intended to fund benefits on a pay-as-you-go basis and no specified reserves have been established to fund retiree health benefits. Current retiree premium rates are based upon the retiree's length of service and range from 20 percent to 40 percent of the plan's total premium. The state provides no direct funding of retiree health benefits.

During the 1997-98 fiscal year, the Preferred Provider Plan provided approximately \$19.6 million in benefits to an average of 4,241 retired employee participants.

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
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- C. Cobra - Federal law requires large employers to continue health insurance benefits to employees who have terminated employment for up to 18 months. The former employees must pay 102 percent of the total premium (employee plus employer share), funded on a pay as you go basis. Insurance coverage is not mandatory if the former employee is eligible for Medicare or has coverage with another group medical plan. The state covered 454 former employees as of June 30, 1998. During fiscal year 1997-98, the Preferred Provider Plan paid approximately \$1.7 million in benefits to this group.

**NOTE 7 – INVESTMENT POOL**

The State Pooled Investment Fund (SPIF) is an external investment pool sponsored by the State of Tennessee. The external portion of SPIF is the Local Government Investment Pool (LGIP) and is reported as a separate investment trust fund. The internal portion, consisting of funds belonging to the state and its component units, has been included in the various funds and component units.

A copy of the SPIF report can be obtained by writing Tennessee Treasury Department, Accounting Division, 9<sup>th</sup> Floor Andrew Jackson Building, Nashville, TN 37243-0231 or by calling (615) 741-1337.

**NOTE 8 - DEPOSITS AND INVESTMENTS**

- A. Investment Policy - The Pooled Investment Fund, administered by the State Treasurer, is authorized by statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The current resolution of that Board gives the Treasurer approval to invest in collateralized certificates of deposit in authorized state depositories; prime commercial paper and prime banker's acceptances; bonds, notes and bills of the United States Treasury or other obligations guaranteed as to principal and interest by the United States or any of its agencies and in repurchase agreements for obligations of the United States or its agencies which are fully guaranteed as to principal and interest by the United States; mutual funds which are limited to investments of the above permitted kinds; and in certain obligations of the state. This resolution further states that the dollar weighted average maturity of the State Pooled Investment Fund shall not exceed 90 days and that no investment may be purchased with a remaining maturity of greater than 397 calendar days. Provided however, an amount not to exceed the lesser of \$300 million or twenty percent (20%) of the book value of the State Pooled Investment Fund at the time such investments are made, may be invested in maturities greater than one year but not greater than five years. The State Pooled Investment Fund is also authorized by policy to contractually loan securities to investment brokers. On January 17, 1995, the State terminated the securities lending contract and therefore had no securities on loan from the State Pooled Investment Fund.

Statutes require the state deposits be secured by collateral securities with a market value of 105% of the face of the deposit secured thereby after considering the applicable FDIC coverage, or the depository must be a member of the State Collateral Pool and the pool must have securities pledged which in total equal the required percentage established by the Collateral Pool Board. In addition, statutes require that financial institutions with a capital-to-assets ratio of less than five percent (5%) must pledge an additional \$100 thousand of collateral securities.

Certificates of deposit are not placed or renewed with a financial institution until adequate collateral is pledged. Open accounts maintained for deposit of state revenues are collateralized on an estimate of the average daily balance in the account based on previous balances and monitored for variation to actual balances. The Treasurer is required, by statute, to evaluate the market value of required collateral monthly, and more frequently if market conditions require. Further, statutes provide the Commissioner of Financial Institutions to advise, on a timely basis, the Treasurer and the Commissioner of Finance and Administration of the condition of each state bank and state chartered savings and loan association, including his recommendations regarding its condition and safety as a state depository. Similar provisions apply to federally chartered banks and savings and loan associations designated as state depositories. This process ensures that institutions whose financial status is uncertain are monitored for collateral sufficiency. All repurchases are done with primary dealers in government securities which have executed a master repurchase agreement with the State which provides for securities underlying repurchase agreements to have a market value of not less than 100 percent nor more than 102 percent of the cost of the repurchase agreement plus accrued interest. Prime commercial paper may be acquired from authorized broker dealers or directly from the issuer. There is no collateral requirement for prime commercial paper.

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The Tennessee Consolidated Retirement System (TCRS), in addition to the guidelines outlined for the Pooled Investment Fund, may invest in long-term investments. The TCRS may invest in bonds, debentures, preferred stock and common stock, and other good and solvent securities subject to the TCRS Board of Trustees approval. The Board has also authorized limited investments of securities in some foreign countries. TCRS may also invest in multifamily residential real estate through direct equity investment vehicles including, but not limited to, sole proprietorship and joint ventures.

**B. Valuation of Investments**

1. State Pooled Investment Fund – The SPIF is not registered with the Securities and Exchange Commission (SEC) as an investment company but, through its investment policy adopted by the Funding Board of the State of Tennessee (Funding Board), operates in a manner consistent with the SEC's rule 2a7 of the Investment Company Act of 1940. Rule 2a7 allows SEC registered mutual funds to use amortized cost to report net assets in computing share prices. Likewise, the SPIF uses amortized cost accounting measures to report investments and share prices. During the fiscal year ended June 30, 1998, the State had not obtained or provided any legally binding guarantees to support the value of participant shares.
2. Other Investments – Investments not included in the SPIF are valued at fair value or amortized cost.

- C. Securities Lending - The TCRS and the Chairs of Excellence (COE), a non-expendable trust fund, are authorized by their investment policies, as adopted by their boards, to enter into collateralized securities lending agreements whereby the TCRS and COE loans its debt and equity securities for a fee to a select few of the highest quality securities firms and banks. Loans must be limited so the total amount on loan does not exceed 30 percent of the TCRS' and COE's assets. The TCRS' and COE's custodian bank manages the lending program and maintains the collateral on behalf of the TCRS and COE. The borrower may deliver collateral to the lending agent in the form of cash or bonds, notes, and treasury bills of the United States or other obligations guaranteed as to principal and interest by the United States or any of its agencies or by the Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, Student Loan Marketing Association and other United States government sponsored corporations or enterprises. Cash received as collateral may be reinvested by the lending agency in accordance with the investment policy, as further restricted under the TCRS and COE securities lending agreement. Collateral securities cannot be pledged or sold unless the borrower defaults.

The loaned securities are initially collateralized at 102 percent of their fair value for domestic securities and 105 percent for international. Collateral is marked-to-market daily and additional collateral is pledged by the borrower if the fair value of the collateral subsequently falls below 100 percent for domestic securities and 105 percent for international. At year-end, TCRS and COE had no securities on loan.

Although there is no specific policy for matching the maturities of the collateral investments and the securities loans, all securities on loan can be terminated on demand by either the TCRS/COE or the borrower. At June 30, 1998, substantially all cash collateral for TCRS was invested in overnight or on-demand investments with a weighted-average term to maturity of four days.

- D. Deposits - Deposits with financial institutions are required to be categorized to indicate the level of risk assumed by the state. Category 1 consists of deposits that are insured or collateralized with securities held by the state or by its agent in the state's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the state's name. Category 3 deposits are uncollateralized. This includes any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the state's name.

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At year end, the carrying amount of deposits in all funds was \$1,460.906 million and the bank balance, including accrued interest, was \$1,478.456 million. Of the bank balance, \$1,478.404 million was (category 1) covered by insurance or collateral (valued at market) held in the state's name by independent custodial banks or segregated in the Federal Reserve Bank in the state's account and \$52 thousand was (category 3) uninsured and uncollateralized.

Cash on deposit with fiscal agent includes \$24.160 million of cash held in a custody account by State Street Bank under a contractual arrangement for master custody services. Monies with the custodial agent are not classified by credit risk, as the custody account relationship does not meet the definition for either a deposit with a financial institution or a security.

- E. Investments - Investments are also required to be categorized to indicate the level of risk assumed by the state. Category 1 consists of investments that are insured or registered or for which the securities are held by the state or its agent in the state's name. Category 2 consists of uninsured and unregistered investments for which the securities are held by the counterparties' trust department or agent in the state's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparties' trust department or agent but not in the state's name. Investments are categorized below for all funds (expressed in thousands):

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PENSION TRUST, POOLED INVESTMENT, AND OTHER FUNDS

	<u>Category</u>			Carrying	Fair
	<u>1</u>	<u>2</u>	<u>3</u>	<u>Amount</u>	<u>Value</u> <u>6/30/98</u>
Cash Equivalents and Short-Term Investments:					
Commercial Paper	\$ 1,873,827			\$ 1,873,827	\$ 1,873,827
Repurchase Agreements	27,500			27,500	27,500
Government Securities	899,824			899,824	896,396
Corporate Securities	<u>31,584</u>			<u>31,584</u>	<u>31,584</u>
Total Cash Equivalents and Short-Term Investments	<u>2,832,735</u>			<u>2,832,735</u>	<u>2,829,307</u>
Long-Term Investments:					
Domestic Securities:					
Government Securities - not on loan	7,521,433			7,521,433	7,521,433
Corporate Bonds	3,105,127			3,105,127	3,105,127
Corporate Stocks	6,569,009			6,569,009	6,569,009
Margin Deposits on Future Contracts:					
Domestic Government Bonds		\$ 5,092		5,092	5,092
International Securities:					
Government Bonds	1,351,560			1,351,560	1,351,560
Corporate Bonds	222,373			222,373	222,373
Corporate Stocks	<u>1,414,824</u>			<u>1,414,824</u>	<u>1,414,824</u>
Total Long-Term Investments	<u>20,184,326</u>		<u>5,092</u>	<u>20,189,418</u>	<u>20,189,418</u>
	<u>\$23,017,061</u>		<u>\$ 5,092</u>	23,022,153	23,018,725
Investments Held by Broker-Dealers Under Securities on Loan Contracts:					
Domestic Securities:					
Mutual Funds				1,120	1,120
Unsettled Investment Acquisitions:					
Domestic Securities:					
Corporate Stocks				12,064	12,064
International Securities:					
Corporate Stocks				35,876	35,876
Investments in Deferred Compensation				134,084	134,084
Unemployment Compensation Pool				<u>889,684</u>	<u>889,684</u>
Total Investments and Cash Equivalents				<u>\$24,094,981</u>	<u>\$24,091,553</u>



**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

F. Component Units

The various component units are generally governed by the same basic State statutes as the State’s investments described in Note 8A.

1. University of Tennessee

At year end, the carrying amount of deposits for the University of Tennessee was \$11.662 million and the bank balance was \$13.789 million. The entire bank balance was (category 1) covered by insurance or collateral (valued at market) held in the University's name by independent custodial banks.

The investments for the University of Tennessee are categorized below (expressed in thousands):

	<u>Category</u>			<u>Carrying</u>	<u>Fair</u>
	<u>1</u>	<u>2</u>	<u>3</u>	<u>Amount</u>	<u>Value</u>
					<u>6/30/98</u>
Cash Equivalents:					
Commercial Paper	\$ 86,516			\$ 86,516	\$ 86,516
Repurchase Agreements	9,000	\$ 800		9,800	9,800
Government Securities	<u>185,397</u>	<u>          </u>		<u>185,397</u>	<u>185,397</u>
Total Cash Equivalents	<u>280,913</u>	<u>800</u>		<u>281,713</u>	<u>281,713</u>
Investments:					
Domestic Securities:					
Government Securities	18,918	36,069		54,987	54,987
Corporate Bonds	3,727	34,656		38,383	38,383
Corporate Stocks	104,794	5,951		110,745	110,745
Collateralized Mortgage Securities	2,609		\$ 406	3,015	3,015
Other	29			29	29
International Securities:					
Corporate Stocks	<u>2,762</u>	<u>          </u>	<u>          </u>	<u>2,762</u>	<u>2,762</u>
Total Investments	<u>132,839</u>	<u>76,676</u>	<u>406</u>	<u>209,921</u>	<u>209,921</u>
	<u>\$ 413,752</u>	<u>\$ 77,476</u>	<u>\$ 406</u>	<u>491,634</u>	<u>491,634</u>
Limited Partnership-Venture					
Capital Funds				12,107	12,107
Real Estate Equity				17,788	17,788
International Equity				23,057	23,057
Mutual Funds				90,820	90,820
Real Estate Gifts				6,784	6,784
Cash Equivalents - assets with bank as custodian				12,798	12,798
Other				<u>8,731</u>	<u>8,731</u>
Total Investments and Cash Equivalents				<u>\$ 663,719</u>	<u>\$ 663,719</u>

STATE OF TENNESSEE

NOTES TO THE FINANCIAL STATEMENTS (Continued)

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2. Tennessee Board of Regents -

At year end, the carrying amount of deposits for the Tennessee Board of Regents was \$51.628 million and the bank balance was \$68.446 million. Of the bank balance, \$65.994 million was (category 1) covered by insurance or collateral (valued at market) held in the University's name by independent custodial banks or segregated in the Federal Reserve Bank in the University’s name, \$1.878 million was (category 2) collateralized with securities held by the pledging financial institution’s trust department or agent in the University’s name, and \$.574 million was (category 3) uninsured and uncollateralized. In addition, at June 30, 1998, the University had \$197.332 million being held by the State in the Local Government Investment Pool.

The investments for the Tennessee Board of Regents are categorized below (expressed in thousands):

	Category			Carrying Amount	Fair Value 6/30/98
	1	2	3		
Investments:					
Domestic Securities:					
Commercial Paper	\$ 6,646			\$ 6,646	\$ 6,646
Repurchase Agreements			\$ 53	53	53
Government Securities	45,713	\$ 7,674	2,103	55,490	55,490
Corporate Bonds	2,432	533	725	3,690	3,690
Corporate Stocks	<u>7,592</u>	<u>8,458</u>	<u>1,660</u>	<u>17,710</u>	<u>17,710</u>
Total Investments	<u>\$ 62,383</u>	<u>\$ 16,665</u>	<u>\$ 4,541</u>	\$ 83,589	\$ 83,589
Mutual Funds				13,130	13,130
Money Market Account				<u>4,679</u>	<u>4,679</u>
Total Investments and Cash Equivalents				<u>\$ 101,398</u>	<u>\$ 101,398</u>

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

3. Tennessee Housing Development Agency

At year end, the carrying amount of deposits was \$17.950 million for the Tennessee Housing Development Agency (THDA). THDA’s deposits are in financial institutions which participate in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of custodial credit risk disclosure. In addition, at June 30, 1998, THDA had \$33.876 million being held by the State in the State Pooled Investment Fund.

The investments for the Tennessee Housing Development Agency are categorized below (expressed in thousands):

	<u>Category</u>			<u>Carrying Amount</u>	<u>Fair Value 6/30/98</u>
	<u>1</u>	<u>2</u>	<u>3</u>		
Cash Equivalents and Short-Term Investments:					
Repurchase Agreements	\$ 131,658			\$ 131,658	\$ 131,658
Government Securities	<u>229,494</u>			<u>229,494</u>	<u>229,494</u>
Total Cash Equivalents and Short-Term Investments	<u>361,152</u>			<u>361,152</u>	<u>361,152</u>
Long-Term Investments					
Government Securities	<u>448,534</u>			<u>448,534</u>	<u>448,534</u>
Long-Term Investments	<u>448,534</u>			<u>448,534</u>	<u>448,534</u>
Total Investments and Cash Equivalents	<u>\$ 809,686</u>			<u>\$ 809,686</u>	<u>\$ 809,686</u>

4. Tennessee State School Bond Authority

At year end, the carrying amount of deposits was \$2.282 million for the Tennessee State School Bond Authority (TSSBA). TSSBA’s deposits are in financial institutions which participate in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of custodial credit risk disclosure. In addition, at June 30, 1998, TSSBA had \$7.988 million being held by the State in the State Pooled Investment Fund.

The investments for the Tennessee School Bond Authority are categorized below (expressed in thousands):

	<u>Category</u>			<u>Carrying Amount</u>	<u>Fair Value 6/30/98</u>
	<u>1</u>	<u>2</u>	<u>3</u>		
Investments:					
Domestic Securities:					
Government Securities	\$ 47,608			\$ 47,608	\$ 47,608
	<u>\$ 47,608</u>			<u>47,608</u>	<u>47,608</u>
Total Investments				<u>\$ 47,608</u>	<u>\$ 47,608</u>

STATE OF TENNESSEE  
NOTES TO THE FINANCIAL STATEMENTS (Continued)  
JUNE 30, 1998

NOTE 9 - COMMITMENTS AND CONTINGENCIES

- A. Sick Leave - It is the state's policy to record the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent due to illness, injury or related family death, there was no liability for sick leave at June 30, 1998. The estimated accumulated amount of unused sick leave at that date was \$311.0 million.
- B. Operating Leases - The state has entered into various operating leases for land, buildings and equipment. All leases contain termination clauses providing for cancellation after 30, 60 or 90 days' written notice to lessors. In addition, all leases contain appropriation clauses indicating that continuation of the lease is subject to funding by the legislature. It is expected that in the normal course of business most of these leases will be replaced by similar leases. Facilities Revolving Fund, an Internal Service Fund, has entered into various operating leases which have noncancelable lease terms. Below is a schedule of future minimum lease payments under these leases (expressed in thousands).

<u>For the Year(s)</u> <u>Ended June 30</u>	<u>Noncancelable</u> <u>Operating Leases</u>
1999	\$ 10,259
2000	7,745
2001	4,992
2002	3,764
2003	2,420
later years	<u>3,140</u>
Total Minimum Payments Required	<u>\$32,320</u>

Expenditures for rent under leases for the years ended June 30, 1998 and 1997 amounted to \$28.8 million and \$35.6 million, respectively.

- C. Highway Construction Projects - At June 30, 1998, the Department of Transportation had contractual commitments of approximately \$429.3 million for construction of various highway projects. Funding of these future expenditures is expected to be provided from federal grants (\$327.6 million) and general obligation bond proceeds (\$101.7 million).
- D. Litigation - Litigation has been brought against the State which challenges the conditions at Arlington Developmental Center. The State is under court order to remedy the situation and believes the Center is making satisfactory progress. In addition, the State was involved in litigation involving the Clover Bottom Developmental Center. A settlement was reached in the Clover Bottom litigation under which the State would work toward community placement of persons with developmental disabilities from all three developmental centers. The State is also party to numerous other legal proceedings, many of which normally recur in governmental operations. In the opinions of the Attorney General and General Counsel for the University of Tennessee system, final settlement of these matters will have no material effect on the accompanying financial statements.
- E. Federal Grants - The state has received federal grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under terms of the grants, it is believed that any required reimbursements will not be material.

The Health Care Financing Administration (HCFA) is corresponding with several states which impose taxes on nursing homes and also provide grants to help needy private pay patients meet their nursing home payment burdens. Tennessee is one of the states in discussion with HCFA. To date HCFA has not asserted a claim related to this issue.

Inconsistencies in the rate setting process for residential treatment services provided to children in state custody may have created overbillings to the TennCare Program. Any potential overpayment by the federal grantor because of these inconsistencies cannot be quantified.

**STATE OF TENNESSEE**  
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 1998**

- F. Loan Guarantees - The Tennessee Student Assistance Corporation (TSAC), a component unit, operates the Guaranteed Student Loans Program. The U. S. Department of Education (USDE) reinsures the student loans up to 100% of their principal amounts. At June 30, 1998, TSAC was guarantor of \$1.810 billion in student loans, substantially all of which were reinsured by the USDE. The state has no obligation under these student loan guarantees in the event of default.
- G. Performance Collateral - The state is custodian for other securities which collateralize contractor/vendor performance. These securities total some \$84.8 million at June 30, 1998 and are not reported elsewhere in the accompanying financial statements.
- H. Nashville Correctional Facilities Revenue Bonds - In June 1991, revenue bonds were issued by the Metropolitan Government of Nashville which have an outstanding balance of some \$20.62 million as of June 30, 1998. These bonds are obligations of the Metropolitan Government of Nashville. The state is committed to pay Nashville for the housing of locally sentenced inmates, including debt service on the bonds.
- I. Year 2000 Readiness Disclosure – The “Year 2000 Issue” (“Y2K”) arises because most computer software programs allocate two digits to the data field for “year” on the assumption that the first two digits will be “19”. Such programs will thus interpret the year 2000 as the year 1900, the year 2001 as 1901, etc. Absent reprogramming Y2K affects both computer hardware (i.e., the embedded logic of computer chips) and computer software, and could impact both the ability to enter data into the computer programs and the ability of such programs to correctly process data. Y2K affects the computer applications and other equipment of the State and the State’s vendors, investment providers, bond trustees and any persons with whom the State has contracted.

The State has assessed the impact of Y2K on its computer applications. The State has completed its assessment and has determined that certain computer applications are mission-critical, certain are critical, and certain are supportive. Mission-critical computer applications are those for which there are no reliable manual alternatives, and for which failure to be in Y2K compliance would prevent the State from fulfilling its mission. Critical computer applications are those for which there are manual alternatives, but the State would unlikely be able to fully or efficiently perform the functions manually, because of the volume of manual activity that would be required. Supportive computer applications are those for which there are manual alternatives and the State expects to be able to perform such functions manually, if necessary.

The State has 148 mission-critical and critical computer applications, and as of June 30, 1998 the State has assessed 100% of such applications and remediated 50% of such applications. The State considers remediation, in this context, to mean either the successful conversion of an existing computer application or the replacement of an existing application with a new application. The State is continuing the remediation and testing of the computer applications and expects to complete the vast majority of such procedures by December 1998. Those under contract (2 of 148) are expected to be completed by June 1999, at a cost of \$4.2 million. The State’s mainframe system provides the supporting computer system infrastructure upon which the State’s application systems reside and are processed. The State’s mainframe will be replaced in November 1998 and at such time should be Y2K compliant. In addition, the State is in the process of assessing the Y2K effect on other equipment. The State is not presently aware of any non-compliance by its yet untested mission-critical and critical computer applications and other equipment or of any costs to achieve Y2K compliance that will have a material negative impact on the State’s operations or financial status; however, the State can give no assurance that circumstances will not change.

The State has begun soliciting information from other organizations whose Y2K compliance could affect the State regarding the status of their assessment, testing and remediation of their computer applications and other equipment. Of the organizations that have responded to date, all expect to achieve compliance in a manner that will not have a materially negative effect on the State’s operations or financial status although no assurances can be given that circumstances will not change. The State does not have full and complete information, however, from these other organizations regarding the status of implementing Y2K compliance. Any failure by some or all of these organizations to be in Y2K compliance may have a material negative impact on the State’s operations or financial status.

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**NOTE 10 - SUBSEQUENT EVENTS**

- A. Primary Government – Subsequent to June 30, 1998, bond anticipation notes were redeemed in the amounts of \$16.2 million on July 1 and \$4.1 million on August 3. On August 12, bond anticipation notes in the amount of \$47.0 million were issued. General obligation bonds, 1998 Series B, were issued on November 19 for \$65.955 million and bond anticipation notes in the amount of \$63.8 million were redeemed on December 1.
- B. Component Units - Subsequent to June 30, 1998, TSSBA issued four series of revenue bonds. Series A & B bonds, in the amount of \$70.325 million, were issued to redeem \$45.8 million of commercial paper and to pay construction costs. Series C, in the amount of \$48.735 million, was issued to refund portions of the outstanding 1972R, 1977A, 1977R, and 1985B bonds. Series D, in the amount of \$33.540 million, was issued to advance refund portions of the outstanding 1992 bonds. TSSBA also issued \$21.8 million in taxable commercial paper to refund University of Tennessee Memorial Research Center and Hospital projects included in the refunded bonds in preparation for the conversion of the hospital to a 501(C)(3) corporation. Also, subsequent to June 30, TSSBA issued \$35.7 million in commercial paper. On January 7, 1999, TSSBA amended its Commercial Paper Resolution to increase the maximum size of the Program to \$200 million.

THDA remarketed Homeownership Program bonds issue 1996-5B in August for \$30 million. THDA redeemed 1974 and 1985 resolution bonds in July for \$59.85 million and redeemed 1985 resolution bonds in October for \$31.094 million. Also, in July, THDA initiated the second draw of the Series 1997CN-1 convertible notes in the amount of \$17.245 million; this draw maximized the principal amount of \$65 million of the note program. In August and November, THDA issued Homeownership Program bonds, issues 1998-2 and 1998-3, for \$30 million and \$80 million. On January 4, 1999, THDA redeemed \$34.061 million of 1974 and 1985 resolution bonds.

At the June 18, 1998, University of Tennessee board meeting, the Board of Trustees authorized the university administration to take necessary steps to create a separate not-for-profit corporation, tax exempt under Internal Revenue Code, Section 501(C)(3) for the purpose of restructuring the operation, maintenance, and governance of the University of Tennessee Memorial Research Center and Hospital. All plans shall be approved by the Board of Trustees, the State Attorney General, and the State Building Commission. The new corporation is expected to commence operations July 1, 1999.